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INTRODUCTION

*“Anyone who has ever struggled with poverty knows
how extremely expensive it is to be poor”*
—James Baldwin¹

The large number of Americans that do not use the traditional banking system is among the untenable economic conditions that the 2008 financial crisis made more visible.² In the United States, over a quarter of Americans are financially excluded from the traditional banking system and arguably economically unstable.³ Approximately 6.5 percent of American households are unbanked, and another 18.7 percent are underbanked.⁴

¹ James Baldwin, *Fifth Avenue Uptown*, ESQUIRE MAG., July 1960, at 70, 73.

² “Banking” as used in this Article refers to providing payment services and the mechanisms, e.g., cash, checks, credit cards, traveler's checks, letters of credit, and electronic fund transfers, used to transfer money from one person to another. See RICHARD S. CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, *THE LAW OF FINANCIAL INSTITUTIONS* 65 (6th ed. 2017) (defining banks as financial intermediaries that offer payment services); see generally FED. DEPOSIT INS. CORP., *FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS* 17 (2017), <https://www.fdic.gov/householdsurvey/2017/2017report.pdf> [<https://perma.cc/7E-AK-J7GD>] [hereinafter 2017 FDIC SURVEY] (defining underbanked and unbanked populations by their use of alternative financial services (AFS) and their use or disuse of the banking system).

³ See generally 2017 FDIC SURVEY, *supra* note 2, at 17 (reporting that that 25.2 percent of surveyed Americans were unbanked or underbanked); Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 123 (2004) (explaining that individuals without bank accounts find it harder to save but are the ones who most need to be able to save).

⁴ 2017 FDIC SURVEY, *supra* note 2, at 17. The survey classifies two different groups who do not use the formal financial services economy as the unbanked and the underbanked. *Id.* An unbanked household is one where no one in the household has a checking or savings account. *Id.* An underbanked household is one that uses alternative financial services providers, such as payday lenders, rent-to-own services, pawn shops, non-bank money orders, non-bank check-cashing services, non-bank remittances, or refund anticipation loans. *Id.*

Consumers, obviously, are opting not to *do banks*,⁵ but the question is why.⁶

For a myriad of sound reasons, underserved Americans use alternative financial services (AFS), or so-called fringe banks⁷, such as check cashers and payday lenders.⁸ Fringe banks are more accessible geographically, take into account consumers' needs for immediate liquidity, and provide reliable products with transparent pricing.⁹ Fringe banks also offer high cost, destabilizing products and services which make it even more difficult for users to move into the financial mainstream.¹⁰ Financial services deregulation coupled with the market

⁵ "We don't do banks" is a common refrain in households that do not have bank accounts. ROURKE O'BRIEN, NEW AM. FOUND., "WE DON'T DO BANKS": FINANCIAL LIVES OF FAMILIES ON PUBLIC ASSISTANCE 1 (2012), <https://static.newamerica.org/attachments/3772-we-dont-do-banks/RourkeMarch2012.280c7e858336448499de926c84038108.pdf> [<https://perma.cc/WQP8-L97W>].

⁶ See 2017 FDIC SURVEY, *supra* note 2, at 4 (listing reasons why consumers were unbanked). Several academics have considered the issue of financial inclusion. See generally Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217 (2004) (using contextual analysis to explain who exactly uses the alternative financial system and why); Mehrsa Baradaran, *How the Poor Got Cut Out of Banking*, 62 EMORY L.J. 483 (2013) (tracking the history of how the two-tier financial system came to be); Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1 (2008) (arguing for increased regulation of the consumer credit industry); Barr, *supra* note 3 (explaining the high cost of alternative financial systems on the poor); Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994 (2006) (discussing the transaction costs of fringe credit reporting); Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589 (2000) (analyzing the rise of the two-tier financial services marketplace and warning that its rise could lead to a rising gap between the have and have-nots in society). Public policy reforms to attract consumers that do not participate in the formal banking system must take into account the reasons that consumers are financially excluded.

⁷ Fringe banking is defined as "the arena of financial services that enables people with bad or no credit and without access to mainstream financial institutions to obtain money." Mary A. Caplan, *Communities Respond to Predatory Lending*, 59 SOC. WORK 149, 149 (2014). Clients of fringe bankers are also often referred to as the unbanked. *Id.* at 152.

⁸ See JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 12-35 (1996) (discussing the fringe banking industry and how households use these alternative financial service providers).

⁹ See Lisa J. Sevron & Antonieta Castro-Cosio, *Reframing the Debate About Financial Inclusion: Evidence from an Up-Close View of Alternative Financial Services* 24-26 (Mar. 5, 2015) (unpublished manuscript) (on file with author).

¹⁰ See Sarah Ludwig, *Credit Scores in America Perpetuate Racial Injustice. Here's How*, GUARDIAN (Oct. 13, 2015), <https://www.theguardian.com/commentisfree/2015/oct/13/your-credit-score-is-racist-heres-why> [<https://perma.cc/4S7Y-DGGT>] (detailing the consequences of using fringe bank products). Fringe bank users, who are primarily Black and Latino, are more likely to have damaged credit. *Id.*

development of asset-backed securitization have morphed the fringe banking market into a multibillion dollar market.¹¹

The two-tiered financial system of formal and informal banks is often justified based on rational choice, meaning individuals opt to use fringe banks.¹² Overwhelmingly, instead of opting out, the underbanked and unbanked are underserved by the traditional banking sector.¹³ Yet, financial inclusion—access to and participation in the formal banking economy—remains the primary way to enter the financial mainstream. The high transaction costs of check cashing and small-dollar credit potentially increase households' financial distress, reducing borrowers' creditworthiness and potentially decreasing their ability to obtain conventional credit and banking services.¹⁴

Participation in the financial mainstream has macro and micro effects. Mainstream consumers are often financially stable and have economic mobility. They build wealth, acquire assets, establish credit, and obtain

¹¹ See MATT FELLOWES & MIA MABANTA, THE BROOKINGS INST., *BANKING ON WEALTH: AMERICA'S NEW RETAIL BANKING INFRASTRUCTURE AND ITS WEALTH-BUILDING POTENTIAL* 11 (2008), <https://www.brookings.edu/research/banking-on-wealth-americas-new-retail-banking-infrastructure-and-its-wealth-building-potential/> [<https://perma.cc/77KJ-LNBZ>] (“The \$100 billion size of the high-cost non-bank basic financial services industry, including check cashers, payday lenders, and pawnshops, points to the high demand for basic financial services among low- and moderate-income customers.”).

¹² See O'BRIEN, *supra* note 5; see also 2017 FDIC SURVEY, *supra* note 2, at 4.

¹³ 2017 FDIC SURVEY, *supra* note 2, at 4. The deregulation of the banking industry in the early 1980s was disadvantageous to low-income consumers because small balance accounts were required to pay increased fees and charges for banking services. Efforts to mitigate the high costs of bank and nonbank services included legislation proposing universal access to bank accounts. See H.R. 2661, 99th Cong. (1985) (requiring every federally insured depository institution to offer a basic account with no minimum balance, no fee for the first eight checks and the first five other withdrawals each month, and specified limits on other charges); H.R. 2011, 99th Cong. (1985) (requiring federally insured depository institutions to offer at least type of account to those with less than \$1000 on deposit). A joint regulatory statement also encouraged banks to offer low-cost basic banking services. BD. OF GOVERNORS, FED. RESERVE SYS., *JOINT POLICY STATEMENT ON BASIC FINANCIAL SERVICES* (1986), <https://www.fdic.gov/regulations/laws/rules/5000-2200.html#fdic5000jointps2> [<https://perma.cc/CB8T-GMF8>].

¹⁴ See Kathryn Fritzdixon, Jim Hawkins & Paige Marta Skiba, *Dude, Where's My Car Title?: The Law, Behavior, and Economics of Title Lending Markets*, 1103 U. ILL. L. REV. 1013, 1041-50 (2014) (outlining the psychological factors that relate to title lending and positing that the true costs of loans are often underestimated); Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, 62 J.L. & ECON. 485, 486 (2019) (using statistical analysis to find a connection between the use of payday lending and higher rates of bankruptcy); see also Scott E. Carrell & Jonathan Zinnman, *In Harm's Way? Payday Loan Access and Military Personnel Performance*, 27 REV. FIN. STUD. 2805, 2825-26 (2014) (positing that members of the armed services create or exacerbate financial problems by borrowing money).

affordable loans.¹⁵ They accumulate savings and have insurance to buffer a crisis. Society benefits when individuals have the necessary tools to develop the skills needed to manage their resources and risks.¹⁶ A basic bank account is one such tool.

While financial inclusion is easily recognized as a developmental priority in emerging countries, it is no less important in a developed country, such as the United States.¹⁷ Banks are integral to the proper functioning of a market economy.¹⁸ Banks accept deposits and provide financial intermediation for consumers,¹⁹ Although fringe banks do not provide deposit accounts,

¹⁵ Use of a bank account has been associated with an increase in savings, female empowerment and consumption, and productive investment of entrepreneurs. See Franklin Allen et al., *The Foundations of Financial Inclusion: Understanding Ownership and Use of Formal Accounts* 32–34 (World Bank Dev. Research Grp., Policy Research Working Paper No. 6290, 2012), <http://documents.worldbank.org/curated/en/348241468329061640/The-foundations-of-financial-inclusion-understanding-ownership-and-use-of-formal-accounts> [<https://perma.cc/Q58H-Q7DY>] (arguing for policies that reduce barriers to financial inclusion in order to encourage and promote financial inclusion).

¹⁶ Broader access to bank accounts can have a positive effect on financial stability because increased financial intermediation results in lower transaction costs and increased dispersal of capital and risk across the economy. See Rui Han & Martin Melecky, *Financial Inclusion for Financial Stability: Access to Bank Deposits and the Growth of Deposits in the Global Financial Crisis* 16–17 (World Bank Policy Research Working Paper No. 6577, 2013), <https://openknowledge.worldbank.org/handle/10986/16010> [<https://perma.cc/BVB5-B7LQ>] (concluding that policies promoting financial inclusion and the broader use of bank deposits can enhance overall financial stability as well as the financial system); see also Selahattin Selsah Pasali, *Where Is the Cheese? Synthesizing a Giant Literature on Causes and Consequences of Financial Sector Development* 5–6 (World Bank Policy Research Working Paper No. 6655, 2013), <http://documents.worldbank.org/curated/en/730041468152101741/pdf/WPS6655.pdf> [<https://perma.cc/3HJQ-DXVC>] (surveying literature on the financial sector and finding a positive relationship between financial development and economic growth and employment).

¹⁷ One study cited the availability of alternatives to formal financial institutions as the primary difference between the United States and other developed countries. See Asli Demirgüç-Kunt & Leora Klapper, *Measuring Financial Inclusion: Explaining Variation in Use of Financial Services Across and Within Countries*, BROOKINGS PAPERS ON ECON. ACTIVITY, Spring 2013, at 279, 279–96 (2013) (studying developed and developing countries by measuring levels and patterns of use of different financial products and services globally and among different groups according to age, sex, and income among other factors which are collected in a World Bank financial inclusion database, “The Global Findex”). The United States lags significantly behind Australia, Canada and the United Kingdom, countries with broadly similar economic development and legal traditions, but have well-developed, sustainable, financial inclusion policies. *Id.*

¹⁸ The Federal Reserve, as the central bank, has the regulatory authority to protect those not well served by our banking system. That responsibility seems even more compelling given the central bank’s financial assistance to investment banks during the subprime financial crisis. See discussion *infra* Part IV.

¹⁹ *Commercial Bank*, INVESTOPEDIA, <https://www.investopedia.com/terms/c/commercialbank.asp> [<https://perma.cc/3TJT-RRMC>] (last visited Jan. 16, 2019).

consumers use them for check cashing, bill paying, and short-term loans. The high cost products and services of fringe banks are justified as filling a void in the regulatory system.²⁰ To the contrary, fringe banking empowers financial exclusion and ultimately contributes to micro and macro financial instability.²¹

This Article participates in the discourse about the efficacy of the financial regulatory system for unbanked and underbanked consumers.²² While banking regulatory agencies recognize the value of diversity and inclusion in the banking economy, this aspirational vision has yielded few

²⁰ See LISA SERVON, *THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES* 7 (2017) (describing the struggles of check casher patrons that result from failures in the bank system); see also *What Is Driving The 'Unbanking Of America'?*, NAT'L PUB. RADIO: FRESH AIR (Jan. 10, 2017, 1:39 PM), <https://www.npr.org/2017/01/10/509126878/what-is-driving-the-unbanking-of-america> [<https://perma.cc/H9XE-QQ2N>] (speaking to the idea that people who use alternative banking systems are making rational choices).

²¹ See Ronald A. Wirtz, *Will That Be Cash, Check or Debtor's Hell?*, FED. RES. BANK OF MINNEAPOLIS (Oct. 1, 2000), <https://www.minneapolisfed.org/publications/fedgazette/will-that-be-cash-check-or-debtors-hell> [<https://perma.cc/3AFW-AN5K>] ("Banks, for example, don't typically make the \$200 loans common among payday lenders. Given poor credit histories, credit cards can also be difficult to obtain (and, in fact, can be the original source of financial problems)."). As discussed *infra* Part III, there is statistical evidence that many U.S. citizens are excluded from formal financial services due to market failures. See also JOSEPH E. STIGLITZ, *THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE* 10 (2012) (describing an IMF study that found a link between inequality and lower growth). But the high and positive growth rates in financial depth vary dramatically between developing and developed countries. See *Financial Depth*, THE WORLD BANK, <https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-depth> [<https://perma.cc/H5LM-4FD2>] (last accessed Aug. 3, 2020) (describing financial depth in relation to economic development). In the United States, a developed country, expanding financial inclusion is also significant for socio-economic development. See *Financial Inclusion: A Challenge for Developing and Developed Countries*, MICROWORLD.ORG (Apr. 24, 2014), <https://www.microworld.org/en/news-from-the-field/article/financial-inclusion-challenge-developing-and-developed-countries> [<https://perma.cc/EU5M-VLA6>] (linking financial inclusion to social inclusion). While there is a strong correlation between not using the formal banking economy and income inequality, it is an erroneous assumption that those who do not use formal financial services are somehow constrained from participating in it. As discussed *infra*, statistics evidence that many U.S. citizens are excluded from formal financial services due to market failures.

²² See Catherine Martin Christopher, *Mobile Banking: The Answer for the Unbanked in America?*, 65 CATH. U. L. REV. 221, 231–43 (2016) (arguing mobile banking has high potential to transform the economic reality of the unbanked in America); see also Baradaran, *supra* note 6, at 509–10 (discussing the success of community development credit unions); Barr, *supra* note 3, at 124 (discussing the benefits and drawbacks of alternative financial service providers); Aleta Sprague, *Next Generation TANF: Reconceptualizing Public Assistance as a Vehicle for Financial Inclusion*, 18 U.D.C. L. REV. 144, 164–74 (2015) (arguing for policy reforms that both remove access barriers and create entry points to the financial mainstream).

real improvements for under- and unbanked communities.²³ The lack of a sustainable, financial inclusion policy has not only developed a robust fringe bank economy, but has embedded its operations in marginalized communities. In this regard, financial exclusion must be viewed within a framework that recognizes the systemic bias and exclusion inherent in the formal banking economy.²⁴ To the extent that the banking regulatory system fails to provide access to basic banking services, it forces the economically marginalized into the informal banking system.

Specifically, this Article proposes eliminating the structural barriers that exclude fringe bank consumers from the financial mainstream.²⁵ This change in the regulatory and supervisory structure of financial institutions will mitigate the risks and the implementation costs of providing access while yielding significant micro and macroeconomic changes.²⁶

This Article makes three points. First, it contends that financial exclusion, through banking deserts and inadequate products and pricing, creates and maintains social and economic domination in low and moderate income (LMI) communities. Social Dominance Theory (SDT) informs the discussion of how the regulatory failure to promote and monitor financial inclusion supports the disparate, two-tier banking system.²⁷ Second, this Article asserts that a transaction account is an essential financial service because it provides an individual with access to the payment system and is critical to

²³ See, e.g., *About Us*, OFF. OF THE COMPTROLLER OF THE CURRENCY, <https://www.occ.treas.gov/about/what-we-do/mission/index-about.html> [<https://perma.cc/8ERX-3PCW>] (last visited Jan. 16, 2019) (committing the OCC to “protecting consumers by making sure banks give fair access and equal treatment to customers and comply with consumer banking laws”). The Office of the Comptroller of the Currency (OCC), charters national banks and savings associations. *Id.* The OCC is an independent bureau of the U.S. Department of the Treasury. *Id.*

²⁴ A society’s dominant group determines the economic and social benefits that the society’s subordinate group will receive, which in this case is access to the higher priced, less beneficial fringe banking system. See *infra* Section II.B.

²⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The most significant reform of the financial industry since the Great Depression, Dodd-Frank created the Consumer Financial Protection Bureau (CFPB). *Id.* at Title X. The CFPB uses its broad regulatory powers to regulate all consumer transactions including those provided by alternative financial service providers. *Id.*

²⁶ See generally ROBERT CULL, TILMAN EHRBECK & NINA HOLLE, CONSULTATIVE GROUP TO ASSIST POOR, FINANCIAL INCLUSION AND DEVELOPMENT: RECENT IMPACT EVIDENCE 1 (2014), <http://www.cgap.org/sites/default/files/FocusNote-Financial-Inclusion-and-Development-April-2014.pdf> [<https://perma.cc/H7SC-98VK>] (summarizing findings about macro- and micro-economic changes that come from increased financial inclusion).

²⁷ Donald P. Morgan et al., *Banking Deserts, Branch Closings, and Soft Information*, LIBERTY STREET ECON. (Mar. 7, 2016), <http://libertystreeteconomics.newyorkfed.org/2016/03/banking-deserts-branch-closings-and-soft-information.html> [<https://perma.cc/476D-8XBW>]. Social Dominance Theory recognizes that group-based hierarchies use legitimizing myths to allocate society’s goods and perpetuate inequalities. See *infra* Section II.B.

accessing other financial services, including savings accounts and credit lines.²⁸ Third, the pervasiveness of the payment system in a market economy dictates a sustainable regulatory response to address financial exclusion.²⁹

This Article concludes by proposing initial steps for a more appropriate regulatory approach to bring fringe bank consumers into the financial mainstream. It addresses the lack of a unified financial inclusion policy by proposing national goals with reporting requirements and awarding tax incentives to federally insured financial institutions that offer LMI transaction accounts.

The remainder of this Article proceeds as follows: Part II exposes the roots of fringe banking and the two-tiered banking system and presents financial exclusion as a socioeconomic system.³⁰ It identifies market failures which resulted in banking exclusion and concludes by arguing that failure to have access to safe, secure, and affordable banking services constitutes socioeconomic domination.

Part III argues that the fiscal financial linkage between payment processing and financial stability underlies the public benefit of banking. It also examines the existing and proposed models of financial inclusion and highlights similarities in approaches to addressing the issues of access to financial services for LMI consumers. Part III concludes by discussing the risks and implementation costs of changes to our regulatory and supervisory structure.³¹

In light of the concerns discussed in previous sections, Part IV discusses the Federal Reserve's responsibility to exercise its regulatory authority to address financial inclusion. Regulation promoting financial inclusion can ease the economic costs of providing entry to the formal

²⁸ "Essential financial services" are generally defined as the basic financial services essential to an individual's daily needs. *See Financial Services Sector*, INVESTOPEDIA (July 7, 2019), <https://www.investopedia.com/ask/answers/030315/what-financial-services-sector.asp> [<https://perma.cc/DDC5-LELL>] (defining the term "essential financial services"). Essential financial services include: "a bank account to receive income; a transaction account to make payments from; a savings account to store money; and access to unsecured credit to manage temporary cash shortages and unexpected expenses." STEFANIE LAMMERMANN, FINANCIAL EXCLUSION AND ACCESS TO CREDIT 26 (2010), http://www.socialwatch.org/sites/default/files/Eu_SW2010_Financial_eng.pdf [<https://perma.cc/GA6P-9LCH>]; *see also* Edward L. Rubin, *The Lifeline Banking Controversy: Putting Deregulation to Work for the Low-Income Consumer*, 67 IND. L.J. 213, 221–30 (1992) (discussing a proposed "lifeline" checking account for low-income people to receive basic checking account services at a below market rate as a matter of social equity).

²⁹ *See generally* MARIA CHIARA MALAGUTI, PAYMENT SYSTEM REGULATION FOR IMPROVING FINANCIAL INCLUSION 2, 4 n.2 (2015), <https://www.cgdev.org/sites/default/files/CGD-Policy-Paper-70-Malaguti-Payment-Systems-Financial-Inclusion-1.pdf> [<https://perma.cc/KS9A-N27C>] ("Payment and settlement systems thus play a crucial role in a market economy and central banks have always had a close interest in them as part of their responsibilities for monetary and financial stability." (citation omitted)).

³⁰ *See infra* Part II.

³¹ *See infra* Part III.

banking economy. It can also impede the private interests of fringe banks that thrive at the expense of LMI consumers. Specifically, Part IV proposes a two-prong approach. First, banks must identify and report on financial inclusion goals as a part of their Community Reinvestment Act (CRA) requirements. Second, to defray the costs of LMI transaction accounts, banks offering these accounts should receive tax incentives.

Who has access to the formal banking economy is an issue of regulatory import. The dearth of affordable banking products and services specifically geared to LMI consumers transforms basic transaction accounts into luxury services that can only be afforded by a select few. The lack of choice and unequal access to financial products is the effect of a failed regulatory structure. Re-aligning the banking regulatory structure is imperative to correct the market's inefficiencies and allow financial institutions an opportunity to both attract and serve those outside of the formal banking economy.

I. DEFINING FINANCIAL EXCLUSION

Financial exclusion, or a lack of access to the quality basic financial services which are essential to daily life, can occur at varying levels. Mainstream financial institutions offer essential financial tools and services, such as deposit and savings accounts, credit, and insurance. By contrast, financial exclusion is recognized widely as a deterrent to economic and social integration. Marginalized groups that do not have access to certain financial products do not appreciate their value. Financial access for financially vulnerable groups requires products with both structures and pricing that promotes financial stability. Without these products, marginalized groups are basically ousted from participating in the formal banking sector.

A. *The Two-Tiered Banking System*

Well-functioning financial systems offer savings, payment services, as well as credit and risk management to a high percentage of consumers and businesses.³² Those who are excluded rely instead on informal alternative financial services.³³

³² See Malaguti, *supra* note 29, at 2 (describing how a nation's financial structure requires an infrastructure built on safety and soundness that consumers trust and perceive as fair).

³³ See Barr, *supra* note 3, at 141–74 (describing the assortment of alternative financial services providers who make basic financial services available to low-income persons).

In 2009, an FDIC biennial survey began evaluating financial inclusion in the formal banking economy.³⁴ The survey measured inclusiveness by determining the number of people who possess insured bank accounts in the previous 12 months.³⁵

The *2017 National Survey of Unbanked and Underbanked Households* reported that 8.4 million or 6.5 percent of American households were “unbanked” or do not have a bank account.³⁶ According to the FDIC, 24.2 million or 18.7 percent of American households are underbanked.³⁷ These consumers conduct their routine financial business, relying upon AFS in addition to, or instead of, traditional financial institutions.³⁸ Together, these numbers reveal that 25.2 percent of American households were financially excluded in 2017.³⁹

³⁴ The Federal Deposit Insurance Reform Conforming Amendment Act requires the FDIC to collect data biannually on the unbanked and underbanked and on traditional financial institutions' efforts to make traditional credit products available to them. Federal Deposit Insurance Reform Conforming Amendments Act of 2005, Pub. L. No. 109-173, § 7(a)(1), 119 Stat. 3601, 3609-10 (2006) (codified at 12 U.S.C. § 1831z (2018)). The Government Accountability Office (GAO) conducted the first study of the unbanked in 2002. According to that report, 51 percent of adults earning less than \$15,000 per year and 36 percent of adults earning within the range of \$15,000 to \$30,000 per year were unbanked. See U.S. Gov't Accountability Office, GAO-02-913, *Electronic Transfers: Use by Federal Payment Recipients Has Increased but Obstacles to Greater Participating Remain 57* (2002), <http://www.gao.gov/new.items/d02913.pdf> [<https://perma.cc/JSZ2-WATV>] (discussing the income groups of the underbanked).

³⁵ Published in 2009, this first survey, the FDIC National Survey of Unbanked and Underbanked Households, found that approximately thirty million or 27.6 percent of U.S. households were either unbanked or underbanked, with 7.7 percent unbanked and 17.9 percent underbanked. See FED. DEPOSIT INS. CORP., 2009 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (2009), https://www.fdic.gov/householdsurvey/2009/full_report.pdf [<https://perma.cc/3EF8-6KFL>] [hereinafter 2009 FDIC SURVEY] (discussing statistical data regarding national, state, and local banking rates).

³⁶ 2017 FDIC SURVEY, *supra* note 2, at 1. As the survey notes, this number may be an underestimate because it does not account for “banked” household residents who do not have an account in their name and do not benefit from a bank account owned by another household resident.

³⁷ 2017 FDIC SURVEY, *supra* note 2, at 17.

³⁸ Most U.S. households (68.4 percent) were “fully banked” in 2017, meaning that the household had a bank account and did not use AFS in the past twelve months. 2017 FDIC SURVEY, *infra* note 2, at 1–2, 36. A total of 25.2 percent was unbanked and underbanked. *Id.* The remaining 6.3 percent of U.S. households had a bank account, but information on their use of AFS was insufficient to categorize the household as either underbanked or fully banked (i.e., banked, underbanked status unknown). *Id.*

³⁹ This compares with 28.3 percent or 68 million adults living in underbanked or unbanked households in 2011. FED. DEPOSIT INS. CORP., 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 4 (2012), https://www.fdic.gov/householdsurvey/2011/2011_unbankedreport.pdf [<https://perma.cc/NSL2-WTTK>] [hereinafter 2011 FDIC SURVEY].

The 2017 survey shows a decline in the unbanked rate “to the lowest level since the survey began in 2009”; the underbanked number remains largely constant.⁴⁰ Only 6.5 percent of the population is unbanked, a record low representing a significant improvement over the all-time high of 8.2 percent in 2011.⁴¹ The underbanked, or the number of U.S. households that have a bank account, but do not use the banking system to meet transaction or credit needs is relatively unchanged since the survey began in 2009 when it was 7.6 percent.⁴² The survey showed 20.1 percent as underbanked in 2011.⁴³

Underserved banking customers are excluded for a myriad of reasons ranging from lack of geographic access and transparency to poor credit.⁴⁴ Yet, the study’s demographics are enlightening, although not surprising.⁴⁵ Minorities and LMI consumers are disproportionately represented in the unbanked and underbanked categories.⁴⁶ The 2017 survey confirms, as in the past, that access to formal financial services is skewed towards whites and the well-educated, while informal financial services are skewed towards minorities and the less-educated.⁴⁷ Geographically, there is more financial exclusion in the southern part of the United States, whose demographics encompass more people of color with less education.⁴⁸

While the FDIC survey identifies that unbanked consumers do not use bank accounts because of “lack of money,” academic research has yielded more specificity. LMI consumers identified their preference for AFS based on the simplicity and convenience of the products as well as the convenience of “bank” hours and locations.⁴⁹ The limited transaction services and lack of

⁴⁰ See 2017 FDIC SURVEY, note 2, at 1 (reporting banking statistics for U.S. households).

⁴¹ *Id.* at 17.

⁴² *Id.*

⁴³ 2011 FDIC SURVEY, *supra* note 41, at 3. For official FDIC reports, surveys, and other related documents, see *Surveys & Data*, ECONOMICINCLUSION.GOV, <http://www.economicinclusion.gov/surveys/> [<https://perma.cc/6YZK-Q5HP>] (last visited Mar. 4, 2020).

⁴⁴ Unbanked households reported not having a checking or savings accounts because they did “[n]ot ha[ve] enough money to feel they need[ed] an account.” 2009 FDIC SURVEY, *supra* note 37, at 11, 20–25.

⁴⁵ The GAO Survey found that 17 percent of adults earning at least \$45,000 per year were banked and that 69% of unbanked consumers had a high school education or less. See U.S. Gen. Accounting Office, *supra* note 34, at 57–58 (offering a graph that displays these numbers).

⁴⁶ 2017 FDIC SURVEY, *supra* note 2, at 2.

⁴⁷ 2009 FDIC SURVEY, *supra* note 44, at 10–11.

⁴⁸ 2017 FDIC SURVEY, *supra* note 2, at 22.

⁴⁹ While some LMI consumers prefer AFS, the undertow of participating in that financial system is the inability of LMI consumers to accumulate both short-and long-term savings. Barr’s Study concludes: “[t]he results [of the study] suggest that existing financial services, credit, and payment systems impose high transaction costs on lower-income households,

savings services limit AFS providers from seeing the client as needing more than a check cashing service. This highlights the need for banks to have the appropriate products and services for this particular clientele.

1. Geographic Exclusion—Bank Deserts

“Bank deserts” are geographical areas without bank branches in a 10-mile radius.⁵⁰ The lack of access to banks also means a lack of access to mainstream financial products, such as mortgages and small business loans, savings accounts and lower-cost credit. To determine the presence of banking deserts, zip codes are compared in terms of bank branches, race and ethnicity, poverty, income, and population.⁵¹ Identifying a banking desert requires integrating annual, geocoded data on bank branches from the FDIC with tract-level data on household income and race from the 2000 census.⁵² Residents of banking deserts are then characterized according to the share of the population which is low income, meaning annual income of \$30,177 or less (the bottom quartile in 2000 dollars) and majority-minority, meaning that more than 50 percent of the population is Black or Hispanic.⁵³

Common demographic characteristics define banking deserts, whether located in urban or rural areas. A recent study examining post-recession bank closures evaluated the locations of FDIC-insured bank branches in relation to U.S. Census Bureau data on households’ income and race. Under this analysis, a banking desert is a “census tract[] in which there are no bank branches within a 10-mile radius from the tracts’ centers.”⁵⁴ Statistically, a banking desert has less than .02 branches per 1,000 residents, or less than one-tenth of the mean.⁵⁵ The average poverty

increase their costs of credit, and reduce their opportunities to save.” MICHAEL S. BARR, NO SLACK: THE FINANCIAL LIVES OF LOW-INCOME AMERICANS 8 (2012).

⁵⁰ One study defined bank deserts as having .02 bank branches in an urban area per 1,000 residents, when the average is 10 times greater. Russell D. Kashian et al., *Banking the Unbanked: Bank Deserts in the United States* 6, 8 (2015) (unpublished manuscript), http://swfa2015.uno.edu/F_Banking/paper_90.pdf [<https://perma.cc/H9WQ-LK25>]. The designation of a geographical area as a bank desert is based on the overlap between household income and race, using U.S. Census Bureau data, and the location of FDIC-insured banks. Morgan et al., *supra* note 28. There is a strong correlation between household income and race. Kashian et al., *supra* note 52, at 8–10.

⁵¹ *Id.* at 6–7.

⁵² *Id.* at 5.

⁵³ “The maximum for this quartile is \$49,626 in urban areas (inside a metropolitan statistical area or MSA) and \$46,095 in rural areas (outside an MSA).” Drew Dahl & Michelle Franke, “*Banking Deserts*” *Become a Concern as Branches Dry Up*, REG’L ECONOMIST, Second Quarter 2017, at 20.

⁵⁴ *Id.*

⁵⁵ Kashian et al., *supra* note 52, at 6.

rate is higher than the overall average and average household per capita income is lower.⁵⁶ A separate study concluded that the disparity of urban bank branch closings means “that residents of low-income census tracts are eighty percent more likely to live in a banking desert than are residents of higher-income tracts.”⁵⁷ Similarly, rural areas disproportionately lost more access to financial services.⁵⁸

A further concern is how bank deserts might expand. A different study projected the location of new deserts if existing, isolated bank branches close.⁵⁹ Under this classification, merging the race and income identifiers with zip codes, there were 1132 deserts in existence at the end of 2014, with a potential for 1055 additional deserts.⁶⁰ The location of future deserts is based on out-of-the-way branches, or those outside the ten-mile range of any others.⁶¹ The projected closures would specifically impact smaller, community banks.⁶²

Bank deserts have a spillover effect; households and communities are unable to leverage financial products and services to their advantage. Accessing credit, such as mortgages and small business loans, builds wealth of individuals and businesses and affects the economic mobility and the economic development of a community.⁶³ Particularly in LMI neighborhoods, relationship banking or knowledge of the community is crucial in lending decisions. Studies on relationship banking in LMI neighborhoods have found that the presence of bank branches affects both credit availability and positive loan performance.

The physical presence of a lender in the neighborhood mitigates risk and expands credit availability.⁶⁴ The presence of bank branches is a favorable

⁵⁶ *Id.* at 8.

⁵⁷ NAT'L CMTY. REINVESTMENT COAL., BANK BRANCH CLOSURES FROM 2008-2016: UNEQUAL IMPACT IN AMERICA'S HEARTLAND (2017), https://ncrc.org/wp-content/uploads/2017/05/NCRC_Branch_Deserts_Research_Memo_050517_2.pdf [<https://perma.cc/7JFZ-G2UQ>]

⁵⁸ *Id.* at 10.

⁵⁹ Dahl & Franke, *supra* note 55, at 20.

⁶⁰ *Id.*

⁶¹ See generally Morgan et al., *supra* note 28, at 20 (describing “[b]ank desert expansion and its impact on minority groups”).

⁶² Dahl & Franke, *supra* note 55, at 20 (explaining that “branches in potential deserts are small, with median deposits of \$23 million in urban areas and \$20 million in rural areas [and] operated by small banks, with median total assets of \$776 million in urban areas and \$317 million in rural areas”).

⁶³ Cf. O. Emre Ergungor, *Bank Branch Presence and Access to Credit in Low-to-Moderate Income Neighborhoods* 4, 6 (Fed. Reserve Bank of Cleveland, Working Paper No. 06-16, 2006), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=951197 [<https://perma.cc/9BV6-JP4D>] (positing that for some borrowers in low-income neighborhoods, collection of soft information is more meaningful than credit scores in assessing creditworthiness).

⁶⁴ O. Emre Ergungor & Stephanie Moulton, *Do Bank Branches Matter Anymore?*, 13 ECON. COMMENTARY 1, 5 (2011).

indicator of the investment potential and entrepreneurship of a community as well as the potential for more financial resources and opportunities.⁶⁵

The lack of access created by banking deserts causes high transaction costs for basic financial services. As discussed below, whether the pricing, product design, and delivery offered to LMI consumers are appropriate for their needs is a crucial area of inquiry in assessing financial exclusion.

2. Pricing, Product Design, and Delivery

In addition to geographical access, use of transaction banking services for LMI consumers is also made more difficult due to product design, delivery, and pricing. All consumers use the same payment system and have credit needs. Broadening access to the formal banking economy requires recognizing that the pricing, product design, and marketing of services that have an appropriate, flexible quality will encourage actual usage.

Financial inclusion as it relates to product design encompasses both usage and quality. Banks traditionally design products for households that receive a moderate income on a regular basis.⁶⁶ Financial providers and products need to be specifically tailored to the needs of LMI consumers in order to manage the risk of what is in essence a non-traditional borrower.⁶⁷

⁶⁵ *See id.* at 1 (arguing that especially in low and moderate-income neighborhoods, there is a positive correlation between local bank branch access, and credit availability for small business lending); *see also* Hoai-Luu Q. Nguyen, Do Bank Branches Still Matter? The Effect of Closings on Local Economic Outcomes 1 (Dec. 2014) (unpublished manuscript), <http://economics.mit.edu/files/10143> [<https://perma.cc/6TJY-3S8E>] (examining the prolonged negative effects of bank branch closings on credit supply to local small businesses).

⁶⁶ Barr, *supra* note 51, at 4. The size and volume of the fringe banking industry continues to expand, as described in a recent report, which notes:

According to a 2003 study by John P. Caskey, a Swarthmore College economics professor, the number of check-cashing outlets grew from 1202 in 1986 to 16,689 in 1993. The annual revenues of ACE Cash Express, one of the nation's largest providers of alternative financial services, grew nearly ten-fold in the decade from 1992 to 2002, from \$26 million to just shy of \$230 million. According to industry figures, check-cashing outlets now process nearly 180 million checks per year, with an estimated face value of \$55 billion.

NATIONAL CMTY. REINVESTMENT FUND, FROM THE MARGINS TO THE MAINSTREAM, A GUIDE TO BUILDING PRODUCTS AND STRATEGIES FOR UNDERBANKED MARKETS i (2008), https://ncif.org/sites/default/files/free-publications/RFSI_StreategyGuide_Complete.pdf [<https://perma.cc/3DEG-BMRG>].

⁶⁷ Bank customer identification rules require including verification through the use of a variety of well-established, permissible forms of identification. *See* 31 C.F.R. § 1020.220 (2020). These identification requirements necessary to open a transaction account exclude some LMI consumers from having a basic deposit account or a savings account. *See* Barr,

Financial exclusion is a problem of supply and demand with risk assessment being a key component. Lenders segment markets according to risk when designing products. The challenge of risk segmentation for higher risk customers in a way that appropriately assesses risk, but is also transparent and non-discriminatory, is two-fold.⁶⁸

The supply and demand aspects of financial inclusion have micro and macro aspects. Low-cost accounts, variety among financial service providers, and governmental policies encouraging inclusion are all necessary to bring the underserved into the formal banking economy.⁶⁹ Finding the balance between the costs of constructing the financial products which excluded consumers need and the sustainability of those products is integral.

The paucity of adequate products and services demonstrates the narrow aspects of the supply problem. Financial providers and products also need to be specifically tailored to the needs of LMI consumers in order to rebut the notion that banks are not for the poor. Monthly charges, minimum balances, as well as overdraft fees and charges are costs and penalties that are a part of product design.⁷⁰ Product availability based on income, geographical location of bank branches, and even lack of branch branches in neighborhoods reinforce negative attitudes and stereotypes about the availability of banks to LMI consumers.

Financial capability, or the knowledge, skill and confidence of consumers, affects the demand for LMI consumer products. Individuals' norms and beliefs affect their choices about using a transaction account or establishing a formal banking relationship. Financial exclusion and isolation

supra note 3, at 184 (describing the impact of identity document requirements on low-income immigrant communities); *see also* Nathalie Martin, *Giving Credit Where Credit Is Due: What We Can Learn from the Banking and Credit Habits of Undocumented Immigrants*, 2015 MICH. ST. L. REV. 989, 1042 (explaining that undocumented immigrants are often weary of formal banking institutions). I should add, however, that banks can and do require information not required by the FDIC rules.

⁶⁸ The first issue is how to not overly advantage low-risk customers, who benefit from a positive presumption because of their account status or a personal relationship between the banker and the customer. *See* Aluma Zernik, *Overdrafts: When Markets, Consumers, and Regulators Collide*, 26 GEO. J. ON POVERTY L. & POL'Y 1, 24 (2018).

⁶⁹ *See generally* Allen et al., *supra* note 15 (discussing the role of financial inclusion policy to broaden access for those financially excluded from the market).

⁷⁰ There is no requirement that banks offer low-cost accounts to consumers, but the FDIC initiated an optional Small-Dollar Loan Pilot Program to encourage banks to offer profitable, affordable small-dollar loans. *FDIC Model Safe Accounts Pilot*, FED. DEPOSIT INS. CORP., <https://www.fdic.gov/consumers/template/> [<https://perma.cc/38YD-DGME>] (last updated Apr. 25, 2012).

occur because the norms and expectations of consumers are not met.⁷¹ Lack of familiarity with appropriate financial products and services often results in financial exclusion. LMI consumers are not able to make the best use of available products when financial pressures occur if they are unaware of them.

Financial capability also encompasses the complexity of financial products.⁷² The jargon, terms in fine print, and varying interest rates require a level of financial judgment and understanding. Transparency and ease when doing banking transactions are prerequisites for full participation in the formal banking economy.⁷³

Finally, whether race or risk is predominant in product pricing and marketing by banks can be difficult to assess given the overlap of income and race in this country. The lack of trust and aversion that minorities, regardless of income, have towards the formal banking system is directly related to this country's sordid history of regulated, discriminatory lending.⁷⁴ Admittedly, banks incur increased delivery costs when providing affordable, inclusive financial products. However, the effectiveness of a financial system is based on the range of financial products for savings, credit, and risk management offered as well as the wide range of people and businesses served.⁷⁵ As discussed below, to ignore the need for governmental regulation to create an

⁷¹ For background on why individuals might opt to use check cashing services instead of formal banking accounts, see Gillian B. White, *Why Poor People Make Expensive Financial Decisions*, ATLANTIC (Jan. 18, 2017), <https://www.theatlantic.com/business/archive/2017/01/underbanked-servon/513542/> [<https://perma.cc/4GEK-LZMJ>] (reviewing Lisa Servon's book, which "explains how changes to both the banking system and the economy inhibited many Americans from accessing basic necessities and building strong financial foundations"); see also Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow TM: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164, S167 (2004) (outlining three reasons why households have difficulty saving: the difficulty of determining the proper savings rate, lack of self-control, and procrastination).

⁷² For background on the "financial capability" as a framework, see generally FIN. INDUS. REGULATORY AUTH. INV'R EDUC. FDN., THE STATE OF U.S. FINANCIAL CAPABILITY: THE 2018 NATIONAL FINANCIAL CAPABILITY STUDY 1 (2019), https://www.usfinancialcapability.org/downloads/NFCS_2018_Report_Natl_Findings.pdf [<https://perma.cc/96ES-4XEA>].

⁷³ See Austin, *supra* note 6, at 1247–50 (discussing the cultural perceptions that low-income consumers have regarding mainstream financial institutions).

⁷⁴ See Brooks, *supra* note 6, at 997–98 (describing the disparities in credit access on the basis of race and class that have emerged in communities where fringe lending is prevalent).

⁷⁵ See generally Asli Demigruc-Kunt, Leora Klapper & Dorothe Singer, *Financial Inclusion and Inclusive Growth: A Review of Recent Empirical Evidence* 18–19 (World Bank Grp. Policy Research Working Paper No. 8040, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2958542&download=yes [<https://perma.cc/2K7X-TMCK>] (finding that, while financial inclusion is especially beneficial to the poorest income levels, that advantage is directly tied to whether the financial infrastructure accommodates small financial transactions).

efficacious, inclusive financial system is to sanction the systematic subordination that financial exclusion creates.⁷⁶

B. Financial Exclusion as Economic Subordination

Access to credit is protected by prohibitions against discriminatory conduct.⁷⁷ What antidiscrimination laws do not guarantee is a right of access to the formal banking sector. Those laws fail to address the systematic bias and exclusion inherent in the formal banking economy. To the extent that the banking regulatory system fails to provide access to even basic banking services, it forces us to consider the systemic reasons why minorities who are economically marginalized are consistently pushed into the informal banking system. There is largely broad indifference to this state of affairs.

One explanation for the broad indifference that encourages fringe banking and hampers financial inclusion is that there is societal discrimination against blacks who are also often economically marginalized. Psychologists argue that the persistence of social inequality is due to the way in which dominant social groups protect existing advantages and disadvantages.⁷⁸ SDT enlightens the discussion on how the regulatory failure to promote and monitor financial inclusion supports the disparate, two-tier banking system.⁷⁹ Its group rights approach is also instructive regarding individual discrimination.

Using SDT's labeling, the banking regulatory system allows mainstream banks to be financially exclusive. This makes mainstream banking consumers and, implicitly, the regulatory framework, the dominant group and fringe bank consumers are the subordinate group. The theory posits that the society's dominant group determines the economic and social

⁷⁶ Franklin, *supra* note 15 (“[Poor and rural residents] report lower barriers in countries with lower costs of accounts and greater penetration of financial service providers.”).

⁷⁷ Fair lending laws guard against the bias that may occur in lending. The Equal Credit Opportunity Act (ECOA) specifies several protected classifications that may not be the basis for a credit decision, with the lender facing liability in compensatory and punitive damages. 15 U.S.C. §§ 1691–1691f (2018) The Fair Housing Act, (FHA) also establishes protected classes in housing-related lending activities. The FHA, a part of the Civil Rights Act of 1968, makes it unlawful for any lender to discriminate against any persons because of their race, color, religion, national origin, handicap, family status, or sex in the sale or rental of housing. 42 U.S.C. § 3604 (2018).

⁷⁸ See Felicia Pratto, Jim Sidanius & Shana Levin, *Social Dominance Theory and The Dynamics of Intergroup Relations: Taking Stock and Looking Forward*, 17 EUR. REV. SOC. PSYCHOL. 271, 272 (2006) (theorizing that all societies tend to be structured into group-based hierarchies from which power and authority are distributed based on legitimizing myths).

⁷⁹ “Financial exclusion is deeply interrelated with social exclusion. . . . Those unable to access finance for enterprise development or personal consumption have greater difficulties in integrating socially and economically.” Lammermann, *supra* note 28, at 27.

benefits that the society's subordinate group will receive.⁸⁰ Existing social hierarchies result in a competitive dynamic that controls economic and social benefits. The dominant group through oppositional asymmetric behavior continually adjusts and redefines its power to adapt to the changing conditions.⁸¹ By creating legitimizing myths, or "collective narratives," the dominant group allocates society's goods and in doing so justifies group domination and perpetuates inequalities.⁸²

The legitimizing myth arising out of racial discrimination and economic marginalization is that fringe banks provide sufficient financial intermediation and access to the payments system. Characterizing the issue of access to safe, reliable intermediation as one of individual choice, cultural preferences, or market efficiency ignores the economic discrimination faced by fringe bank consumers.⁸³ The burden of the increased costs and risks of non-access are borne by those consumers.⁸⁴ Access to effective intermediation is both beneficial and essential because it is difficult, if not unmanageable, to transact economic activities without access to suitable payment systems.

Financial inclusion quantifies the efficiency of a country's payment system. That efficacy depends on the diversity and depth of economic groups served. The result is that in this country, access to the formal banking economy is reserved for the society's dominant group, while the society's subordinate group is relegated to the higher priced, less beneficial fringe banking system. Upon examining the demographics, it becomes clear that the social groups most subjected to financial exclusion are black and poor people.

The demographics of financial exclusion put race and class at the core of unequal treatment. A disproportionate number of those outside the formal economy are people of color.⁸⁵ It is hard to ignore the impact of prior racial

⁸⁰ Pratto, Sidanius & Levin, *supra* note 72, at 273. The dominant and subordinate groups are based on age, gender, and arbitrarily socially constructed characteristics, such as race, ethnicity, and class. *Id.*

⁸¹ Hierarchical societies have social value demarcations and distribute the society's benefits according to the groups' ranking. Group members derive advantages and disadvantages based solely on their placement. Dominant groups have positive social value, e.g., political authority and power, while subordinate groups have negative social value, or low power. *Id.* at 272.

⁸² Darren Lenard Hutchinson, *Preventing Balkanization or Facilitating Racial Domination: A Critique of the New Equal Protection*, 22 VA. J. SOC. POL'Y & L. 1, 8 (2015).

⁸³ Unlike in developing countries where financial inclusion is often needed to stabilize the economy, in developed countries, financial inclusion is a byproduct of efficiency. Malaguti, *supra* note 29, at 2.

⁸⁴ See Eric Yaverbaum, *Financial Exclusion: Why the Poor Get Poorer*, HUFFPOST (Apr. 6, 2015, 8:15 PM ET), https://www.huffpost.com/entry/financial-exclusion-why-the-poor_b_7001914 [<https://perma.cc/9L7T-42JZ>] ("The average full-time worker without a bank account can spend \$40,000 over the course of his or her lifetime just to cash paychecks").

⁸⁵ 2017 FDIC SURVEY, *supra* note 2, at 2–3.

discrimination on the development of the two-tier system.⁸⁶ This racially disparate pattern of providing little to no alternative to fringe banking contributes to the economic insecurity of people of color within the United States. The troubling role of race as evidenced in the financial exclusion statistics shows the impact that is felt by historically marginalized groups. Thus, the failure of law and policy to ameliorate that exclusion is of concern. Without a policy mandate, these consumers remain invisible to the deeply established, highly competitive banking system.⁸⁷

Banking law can enable or reduce social domination.⁸⁸ In this instance, the banking regulatory structure sustains the pre-existing group-based inequality by not providing competitive financial intermediation or access to the payment system for LMI consumers. The mainstream banking economy demonstrates that competition alone does not provide the essential level of payment systems to all segments of society. In fact, the regulatory scheme legitimizes anti-competitive conduct by failing to provide suitable institutions for LMI consumers. United States policy initiatives have not resulted in concrete measures that increase the supply of accessible products, services or locales for fringe bank consumers.⁸⁹

⁸⁶ For example, a report describes “economic insecurity as a norm and security as an exception” among retirees of color “just 8 percent of African-American senior households and only 4 percent of Latino senior households are economically secure with sufficient resources to maintain a basic standard of economic security throughout their projected life expectancy.” TATJANA MESCHÉDE, LAURA SULLIVAN & THOMAS SHAPIRO, *THE CRISIS OF ECONOMIC INSECURITY FOR AFRICAN-AMERICAN AND LATINO SENIORS 2* (2011), <https://www.demos.org/sites/default/files/publications/IASP%20Demos%20Senior%20of%20Color%20Brief%20September%202011.pdf> [https://perma.cc/L5W6-6W2U]. See also Laura Sullivan et al., *Equitable Investments in the Next Generation: Designing Policies to Close the Racial Wealth Gap*, CFED (2016), https://prosperitynow.org/sites/default/files/resources/IASP_CFED_Equitable_Investments_in_the_Next_Generation-FINAL.pdf [https://perma.cc/U3UB-PJEP]; Amy Traub, Laura Sullivan, Tatjana Meschede & Tom Shapiro, *The Asset Value of Whiteness: Understanding the Racial Wealth Gap*, DEMOS (Feb. 6, 2017), <https://www.demos.org/publication/asset-value-whiteness-understanding-racial-wealth-gap> [https://perma.cc/GD88-ZFVT].

⁸⁷ See generally, Cassandra Jones Havard, *Invisible Markets Netting Visible Results: When Sub-Prime Lending Becomes Predatory*, 26 OKLA. CITY U. L. REV. 1057, 1061–71 (2001) (arguing that consumers who are invisible to the traditional banking system are forced into predatory and sub-prime loans which do not accurately price their credit risk).

⁸⁸ As one scholar posits:

Law is an important instrument of social domination. Constitutional law doctrines, for example, make it extremely difficult for persons of color to challenge racial discrimination, but impose few barriers for whites who wish to contest the legality of racial egalitarian remedies.

Darren Lenard Hutchinson, *Continually Reminded of Their Inferior Position: Social Dominance, Implicit Bias, Criminality, and Race*, 46 WASH. U. J.L. & POL'Y 23, 32 (2014).

⁸⁹ The FDIC has endorsed small dollar loans as a viable bank product. See *FDIC Model Safe Accounts Pilot*, *supra* note 67. The regulatory agencies theoretically allow federally insured institutions to offer deposit advance loans as an alternative to payday loans. See 78 Treas.

Access to basic banking services unfairly advantages those who readily have them while disadvantaging those who are affected by systematic anti-competitive conduct.⁹⁰ If the limited access to mainstream banking services is viewed as an exercise of monopoly power, the anticompetitive dynamic of the fringe banking sector is more visible. Indubitably, the regulatory void stridently endorses the structurally unfair and noncompetitive two-tiered banking framework.

The two-tier banking system is anticompetitive in at least two ways. First, fringe banking consumers have “barriers to entry.”⁹¹ The formal banking economy is less attractive to fringe bank consumers because of the risks and size of the investment to enter the market. Product design makes it expensive for fringe bank consumers to invest in the formal banking economy compared to the return on their investment. Risk analyses that are more appropriate for higher-income sector customers should be replaced with the type of nonstandardized risk analysis appropriate for fringe bank consumers making this transition.⁹² Requiring standardization on disclosure transparency, sustainability, appropriate risk evaluations and consumer protection are the type of minimal requirements that are not only beneficial but should be the norm for consumers transitioning into the formal economy.⁹³ Allowing consumer choice and monitoring regulatory costs

Reg. 70624 (2013); 78 Treas. Reg. 70552 (2013). The regulations make the products unduly restrictive. To qualify for a deposit advance loan, the customer must 1) have a deposit account with the bank for at least six months and 2) not have delinquent or adversely classified credits. *See* 78 Treas. Reg. at 70629; *see also* 78 Treas. Reg. at 70556.

⁹⁰ Although “[s]ocial dominance theory’s key insight is its emphasis on the individual-level forces that contribute to the perpetuation of group-based social hierarchies.” Michelle Adams, *Intergroup Rivalry, Anti-Competitive Conduct and Affirmative Action*, 82 B.U. L. REV. 1089, 1108 (2002). The theory is used by analogy in this Article as a way of explaining the collective failure of law and policy to recognize how the inequality among social groups results in a noncompetitive banking environment for LMI consumers.

⁹¹ “Barriers to entry,” which can include governmental regulation, are anticompetitive measures that disrupt other firms from entering a market that is dominated by a firm in the market earning competitive prices. Caskey, *supra* note 8, at 150.

⁹² Relationship lending, which is popular in microfinance, uses nontraditional factors, including “soft” information to assess risk. *See generally* Craig R. Everett, *Group Membership, Relationship Banking and Loan Default Risk: The Case of Online Social Lending*, 7 BANKING & FIN. REV. 15, 15 (2015).

⁹³ The CFPB has authority to review financial product to ensure that they are fair, transparent and competitive. *See* 12 U.S.C. § 5511(a) (2018) (authorizing the CFPB to “implement and, where applicable, enforce federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive”); *see also* Norman I. Silber, *Reasonable Behavior at the CFPB*, 7 BROOK. J. CORP. FIN. & COM. L. 87, 104 (2012) (discussing the expansiveness of the CFPB’s role is in protecting consumers).

should stimulate competition in the market.⁹⁴ Second, fringe banking forces a “lock-out.” The structure of the informal economy is self-perpetuating in that it undermines customers’ ability to move into the formal banking sector.⁹⁵ There is ineffective competition from mainstream banks to provide services to fringe bank customers which by default encourages fringe banking consumers to enter the informal banking system and arguably keeps them there. However, while having a number of providers in a market is a necessary condition for effective competition, a robust market does not assure automatically that the market is effectively competitive for customers.

Individual consumers do not have a legal right to challenge the regulatory structure that excludes them.⁹⁶ Essentially, fringe bank consumers have an absence of choice.⁹⁷ The ineffective competition to provide services to fringe bank customers raises problems with supply. The lack of diversity among fringe bank providers, when left unchallenged, deters potential entrants from entering the market. Fringe banks can then raise prices, limit quality, or restrict product availability.⁹⁸ Moreover, to the extent that the

⁹⁴ Fringe bank customers need nonstandardized risk analysis instead of risk assessments which are appropriate for higher-income sector customers. Shahram Sharifi & G. Michael Flores, Options for Short-Term Credit in the United Kingdom 13–15 (May 4, 2013) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2259542 [<https://perma.cc/P5BD-9ETE>] (discussing the higher costs of offering bank products to LMI consumers).

⁹⁵ Access to transaction accounts leads to the necessary information for lenders to assess creditworthiness. To the contrary, the structure of the fringe banking market “undermines consumers’ access to alternative low-cost credit.” Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994, 997 (2006); see also Drysdale & Keest, *supra* note 6, at 666 (describing fringe loans as “go[ing] up a descending escalator—the fringe customer has to fight hard just to stay in place, and stopping for breath means a ride to the bottom.”).

⁹⁶ In the United States, unlike in the European Union, there is no right to a basic bank account. American consumers who are financially excluded have no way to remedy their financial exclusion without laws that change the regulatory structure as discussed in Part III. See, e.g., Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the Comparability of Fees Related to Payment Accounts, Payment Account Switching and Access to Payment Accounts with Basic Features, 2014 O.J. (L 257), 214, 246. This Article makes the case that consumers should be guaranteed free access to basic payment services, including the ability to save funds and withdraw cash.

⁹⁷ Fringe bank consumers cannot gain access traditional banking services through their own efforts by building credit using fringe services. Roger Swagler, John Burton & Joan Koonce Lewis, *The Alternative Financial Sector: An Overview*, 7 ADVANCING CONSUMER INT. 7, 9 (1995) (explaining that borrowers who pay off obligations to fringe lenders do not see an improvement in their credit record because such transactions are not part of their formal credit history).

⁹⁸ Fringe banks structure products as to evade usury and consumer protection laws. Lynne Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 590, 626–37 (2000).

regulatory scheme fails to require individual banks to measure and improve financial inclusion, it perpetuates the monopolistic fringe bank market.⁹⁹

Admittedly, the banking sector is a private, profit-making enterprise. As the recent financial crisis makes clear, there is substantial government support for the industry. The recent Wall Street Bailout, the powerful and effective banking lobby, and heretofore lax regulation of the AFS are direct and indirect displays of government support.¹⁰⁰ Likewise, government has an obligation to level the playing field for economically vulnerable consumers. A robust regulatory system intervenes where necessary to change incentives in the markets while using aggressive enforcement tools to deter inappropriate behavior.¹⁰¹

Maintenance of an efficacious financial system is a compelling governmental interest. Similarly, financial inclusion raises a single question: Should all citizens be given access to a reliable, safe payments system? The continued denial of an economic advantage tied to a compelling governmental interest sanctions the policy void that keeps the unbanked and underbanked out of the financial mainstream.

The existing two-tier financial system does not provide fringe bank consumers with effective intermediation. The role of the Federal Reserve, as the architect of the payment system, requires examination. As discussed below in Part II, efficient, affordable, access to the payment system is the premise for arguing that access to the formal banking sector is a public good.

II. THE PUBLIC BENEFIT OF BANKING

Payment systems, which include the settlement and dispersion of funds, are the basis for monetary exchange in an economy. This financial infrastructure is crucial to facilitating access to financial services and the safe transfer of funds. Payment systems are also a critical component of directing relevant information in risk assessment. Currently, banks dominate the payment system, which is regulated by the Federal Reserve. As the central bank, the Federal Reserve regulates both the monetary policy and the public functions of banking. Fringe bank consumers currently have access to the payment system though high costs servicers. The question becomes whether

⁹⁹ See discussion *infra* Part IV (arguing for a financial inclusion measurement as a part of a bank's annual CRA exam).

¹⁰⁰ Most AFS providers are regulated at the state level, but the CFPB has limited authority to regulate some of the credit products regardless of the state's regulatory authority. See *generally* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 84 Fed. Reg. 4252 (Feb. 14, 2019) (discussing, in part, CFPB regulation of payday lenders).

¹⁰¹ Financial Services Authority, Production Intervention 27–28, 42 (Discussion Paper No. 11/1, 2011) (U.K.).

the financial infrastructure and regulatory policy can and should be adjusted to accommodate the needs of and provide competitive access to banks' transaction accounts for fringe bank consumers.

A. *The Fiscal-Financial Linkage*

Traditionally, the financial system and overall economy depend on the unique functions that banks provide. Banks historically have provided three essential fiscal functions: (1) providing a reliable payment system by issuing transaction accounts; (2) maintaining financial stability throughout the economy as a back-up source of liquidity and (3) facilitating monetary policy.¹⁰² For this reason, banks are often labeled as “special.”¹⁰³ In the financial sector, banks are a unique public-private hybrid: privately owned, but requiring permission for a charter; highly regulated with explicit conditions on their business activities.¹⁰⁴

Banks are an integral part of the fiscal and financial linkages in a market-capitalist economy. The underlying policy of the banking regulatory structure is public trust. The integrated functions and essential linkages between the fiscal and financial sectors cause concern for the central bank. Payment processing, financial stability, and monetary stability are economic risks that the Federal Reserve as the central bank oversees to keep the economy functioning well.

¹⁰² Banks provide a safe and liable payments system, Article 4 of the Uniform Commercial Code along with federal statutes, and regulations issued by the Board of Governors of the Federal Reserve System govern the mechanism of the bank payments process. *See, e.g.*, 12 U.S.C. §§ 4001–4010 (2018) (Expedited Funds Availability Act); *id.* §§ 5001–5018 (Check Clearing for the 21st Century Act); 12 C.F.R. § 229 (2020) (Availability of Funds and Collection of Checks).

¹⁰³ *See, e.g.*, E. GERALD CORRIGAN, FED. RESERVE BANK OF MINNEAPOLIS, ARE BANKS SPECIAL? (1983) <https://www.minneapolisfed.org/publications/annual-reports/are-banks-special> [<https://perma.cc/8Z8Y-64F6>].

¹⁰⁴ *See, e.g.*, 12 U.S.C. § 203 (describing, for instance, the powers of the FDIC to install a Conservator to take control of a bank in certain scenarios). Bank dominance of the payment system can have a domino effect in case of bank failure. *See* Edward E. Furash, *Banks are Obsolete—and Who Cares*, 1 N.C. BANK. INST. 1, 8 (1997) (describing how a loss at one institution immediately affects the solvency of other institutions and the financial system). The inter-relatedness of bank and nonbank financial intermediaries increases the potential of systemic failure. *See* Rizwaan Jameel Mokal, *Liquidity, Systemic Risk, and the Bankruptcy Treatment of Financial Contracts*, 10 BROOK. J. CORP. FIN. & COM. L. 15, 72–73 (2015) (concluding that mitigating systemic risk requires individual financial institutions to go beyond contract immunities to protect against domino risk).

1. Payment Processing

Banks operate the payment system that allows parties to establish transaction accounts.¹⁰⁵ They provide consumers with a safe place for deposits, savings, payment processing as well as short- and long-term credit. Banks provide businesses with back-up credit lines. They also facilitate the economy by providing a way to process payments, distribute currency.¹⁰⁶

Depositors provide banks with the funds needed to operate and are protected by deposit insurance. Deposits are liabilities on the bank's balance sheet that must be paid on demand. Banks use those deposits to make loans, which are assets with a long-term repayment. The bank's capital covers the risk of loan loss and provides a cushion of liquid assets sufficient to preserve depositors' confidence that any withdrawal demands will be met.¹⁰⁷

Deposit insurance provides protection that gives depositors confidence. It also provides monitoring of the institution's solvency that individual depositors find too costly.¹⁰⁸ The FDIC, created in response to bank runs during the 1932 Depression, guarantees a return of deposit liabilities in case of bank failure.¹⁰⁹ That governmental protection is crucial in preserving financial stability by providing building consumer trust in banks. Banks further benefit in that traditional deposit insurance is subsidized by the federal government and governmental intervention, when needed, is an appropriate remedy.

¹⁰⁵ The increased interlinkages of banks and nonbank financial intermediaries that participate in payment systems increase the risk exposure throughout the financial system. As one commentator said, "I see little to be gained by insisting that banks always be the only type of entity that can provide such services." Governor Edward W. Kelley, Jr., Bank of Eng., Remarks at the Seminar on Banking Soundness and Monetary Policy in a World of Global Capital Markets (Jan. 29, 1997), <https://www.federalreserve.gov/boarddocs/speeches/1997/19970129.htm> [<https://perma.cc/D6C5-ERBB>].

¹⁰⁶ The Federal Reserve through its regulation of banks has the responsibility to maintain a sound banking system and a healthy economy by raising and lowering interest rates, which both manages consumer demand and monitors financial stability. Troy S. Brown, *Legal Political Moral Hazard: Does the Dodd- Frank Act End Too Big to Fail?*, 3 ALA. C.R. & C.L. L. REV. 1, 56-57 (2012).

¹⁰⁷ See Gerard Genotte & David Pyle, *Capital Controls and Bank Risk*, 5 J. BANK. & FIN. 805, 805 (1991) (defining bank capital).

¹⁰⁸ Congress created the FDIC in 1932 as a part of the Glass-Steagall Act, which put in place extensive regulatory reforms. See generally Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified as amended at 12 U.S.C. § 227 (2018)).

¹⁰⁹ See 12 U.S.C. §§ 1811, 1821 (2018) (describing the creation of the FDIC and the function of FDIC insurance funds).

2. Financial Stability

Historically, banks have been a separate, distinct, highly regulated industry within financial markets.¹¹⁰ In a modern economic system, banks are essential to economic growth because they provide credit and allocate resources.¹¹¹ The deregulation of financial institutions allowed banks to expand into other financial markets, such as securities, funds management and insurance, and created other types of financial institutions, e.g., private equity groups.¹¹² It is the financial stability of these integrated markets that provides the argument that access to the banking system is a public good.

a. Integrated Financial Markets

Financial crises are prevalent, though controlled, in modern market economies.¹¹³ Central banks are crucial to restoring financial stability and protecting the entire economic system from insolvency. The recent global financial crisis that began in the American subprime mortgage market required central banks to take individual and concerted actions to stabilize the global economy.¹¹⁴ The Federal Reserve's response to the financial crisis resulted in the imposition of conventional policy actions—fiscal stimulus, closing of financial institutions, and capital injections into financial institutions—as well as unconventional policy actions, like providing direct support to important financial markets, lending to

¹¹⁰ See Prasad Krishnamurthy, *George Stigler on His Head: The Consequences of Restrictions on Competition in (Bank) Regulation*, 35 YALE J. ON REG. 823, 850 (2018) (critiquing banking regulation as creating a false tradeoff between competition and risk and recommending that deposit insurance be structured in a way that eliminates risk-taking).

¹¹¹ See Yoshiro Miwa & J. Mark Ramseyer, *Banks and Economic Growth: Implications from Japanese History*, 45 J.L. & ECON. 127, 130–31 (2002) (discussing the role of banks in the development of transitional and developed economies).

¹¹² See Charles K. Whitehead, *The Volcker Rule and Evolving Financial Markets*, 1 HARV. BUS. L. REV. 39, 44 (2011) (arguing that restrictive banking regulations such as the Volcker Rule ignore modern finance and new banking market participants).

¹¹³ See Neil H. Buchanan & Michael C. Dorf, *Don't End or Audit The Fed: Central Bank Independence In An Age of Austerity*, 102 CORNELL L. REV. 1, 43–44, 45 (2016) (describing the Federal Reserve's role as an independent central bank in mitigating the frequency and severity of financial and economic crises).

¹¹⁴ See Kara M. Westercamp, *A Crack in the Facade and the Whole Building Came Tumbling Down: A Critical Examination of the Central Banks' Response to the Subprime Mortgage Loan Crisis and Global Financial Market Turmoil*, 18 TRANSNAT'L L. & CONTEMP. PROBS. 197, 233 (2009) (discussing the interventionist role of central banks during a liquidity crisis).

nonbank institutions and investors, as well as purchasing securities not typically held in central bank portfolios.¹¹⁵

The interlinkages of large banks in the economic system required government intervention during the recent financial crisis to prevent a massive collapse of the country's economic system. Similarly, the solvency of financial markets became dependent on whether governmental intervention would shore up financial institutions.¹¹⁶ In this way, the fiscal or economic sector and the financial sector became indistinguishably interconnected. To the extent that fiscal and macroeconomic policies are crafted based on their effect on financial markets, economic policy is driving financial regulation and vice versa. Consequently, the regulation of the financial sector has become dependent on the health of the underlying national economy.¹¹⁷

b. Maturity Transformation and the Repurchase Market

Maturity transformation is at the heart of modern banking. The presence of maturity transformation—borrowing short to lend long—depends on investors having confidence in the banking system.¹¹⁸ Investment banks finance themselves with short-term debt or “repo”¹¹⁹ using large amounts of available cash to earn short-term interest. The collateral for these loans are securitized assets, such as mortgages, with long payment terms. Using long-term assets to

¹¹⁵ GORDON H. SELLON, JR., FINANCIAL STABILITY AND MACROECONOMIC POLICY—AN INTRODUCTION TO THE 2009 ECONOMIC POLICY SYMPOSIUM xxiii, xxiv (2009), <https://www.kansascityfed.org/publicat/sympos/2009/papers/introduction-2009.pdf> [perma.cc/D2T3-5JM].

¹¹⁶ See, e.g., *Bear Stearns Company Profile*, INVESTOPEDIA, <https://www.investopedia.com/terms/b/bear-stearns.asp> [perma.cc/DE2D-CWFS] (last updated Oct. 4, 2019) (describing the collapse of Bear Stearns and subsequent support from the Federal Reserve).

¹¹⁷ Y.V. Reddy, *Financial Sector Regulation and Macroeconomic Policy* 33 (Bank for Int'l Settlements Working Paper No. 62, 2012), https://www.cafral.org.in/sfControl/content/DocumentFile/1219201344602PM_BP62_%2009_Paper_by_Y_V_Reddy.pdf [https://perma.cc/EX7M-VZZV].

¹¹⁸ As explained by one article, “maturity transformation” involves “the bank transform[ing] short-term, highly liquid liabilities like deposits into illiquid assets like bank loans to businesses, and these bank loans are critical to fueling economic growth. Without government regulation, however, the ‘maturity mismatch’ inherent in maturity transformation makes such a bank highly vulnerable to runs.” John C. Dugan, *Addressing the Fundamental Banking Policy Problem of Runs: Effectively Subordinating Large Amounts of Long-Term Debt to Short-Term Debt to End “Too-Big-to-Fail,”* 22 N.C. BANKING INST. 11, 13 (2018)

¹¹⁹ See Jonathan R. Macey & Geoffrey P. Miller, *Nondeposit Deposits and the Future of Bank Regulation*, 91 MICH. L. REV. 237, 254–55 (1992) (discussing the history and function of repurchase agreements, or “repos”).

finance short-term debt creates a maturity mismatch.¹²⁰ During the subprime crisis, there was a “repo run” when investors became uncertain about the value of the underlying collateral.¹²¹

The risky process of maturity transformation depends to a large extent on investors having confidence in the payments system. Nonbank financial institutions, sometimes called shadow banks, pose a significant risk to the monetary system.¹²² “Lightly regulated,” these institutions are “deeply reliant on uninsured short-term debt that pose [sic] significant risk.”¹²³ It is the systemic risk in the short-term lending market that can threaten the financial stability of a nation’s economy, making central bank guarantees necessary to shore up that market.¹²⁴ Central banks help to contain contagion effects which occur when investors withdraw short-term wholesale funding on which many large financial firms and shadow banks rely.¹²⁵ During the global financial

¹²⁰ Zachary J. Gubler, *Regulating in the Shadows: Systemic Moral Hazard and the Problem of the Twenty-First Century Bank Run*, 63 ALA. L. REV. 221, 239–40 (2012).

¹²¹ *Fed Scholars: A Run on the Repurchase Market Caused the Financial Crisis and Will Probably Happen Again*, REPOWATCH (May 23, 2011), <https://repowatch.org/2011/05/23/fed-scholars-a-run-on-the-repurchase-market-caused-the-financial-crisis-and-will-probably-happen-again> [perma.cc/SJG9-Y6XN].

¹²² Ben Bernanke, former Chairman of the Federal Reserve, defined “shadow banking” as “a diverse set of institutions and markets that, collectively, carry out traditional banking functions—but do so outside, or in ways only loosely linked to, the traditional system of regulated depository institutions.” Ben S. Bernanke, Chairman, Fed. Reserve Sys., *Some Reflections on the Crisis and the Policy Response*, Russell Sage Foundation & Century Foundation Conference on “Rethinking Finance” (Apr. 13, 2012).

¹²³ THE VOLCKER ALLIANCE, UNFINISHED BUSINESS: BANKING IN THE SHADOWS 5 (2016), https://www.volckeralliance.org/sites/default/files/attachments/VolckerAlliance_UnfinishedBusinessBankingInTheShadows.pdf [perma.cc/U55V-K2N9].

¹²⁴ One commentator made the following observation: “After four years of efforts, regulators and the financial firms with the most at stake have failed to extinguish systemic risk in a crucial short-term lending market,” the repurchase market, “that greases the wheels of trading in U.S. Treasuries.” Liz McCormick, *In Market That Ensnared Lehman, Risk of Debt Fire Sales Lingers*, BLOOMBERG (May 25, 2016), <https://www.bloomberg.com/news/articles/2016-05-25/in-repo-market-that-ensnared-lehman-risk-of-fire-sale-lingers> [perma.cc/6P6Z-N4EQ].

¹²⁵ Problems in the wholesale market arguably still exist. One government study found: “Data gaps persist in securities financing transactions, including repo and securities lending. The markets for these critical short-term funding instruments remain vulnerable to runs and asset fire sales. Yet comprehensive data on so-called bilateral repo and securities lending transactions are scant.” Richard Berner, Dir., Office of Fin. Research, Remarks by Office of Financial Research Director Richard Berner at the Third Annual Workshop on Financial Interconnectedness (Apr. 12, 2016); see also PRICEWATERHOUSE COOPERS & BNY MELLON, THE FUTURE OF WHOLESALE FUNDING MARKETS 13 (2015), <https://www.bnymellon.com/global-assets/pdf/our-thinking/the-future-of-wholesale-funding-markets.pdf> [perma.cc/6FKR-LMQC] (describing the repo market as the “circulatory system” and stressing its reliance on the “smooth transfer of collateral.”).

crisis, central banks protected investment banks from the threat of contagion or a run on bank assets.¹²⁶

Regulatory policies are likewise designed to ensure against financial instability.¹²⁷ Underlying the “Too Big to Fail Doctrine” is the need for stability in the banking system and in the nation’s monetary economy. Disruptions to the payment system destroy the confidence that the markets need to operate. Infusing the capital needed to stabilize the economy is among the primary reasons that central banks exist. The chief concern is that financial strain creates adverse consequences for the real economy. Thus, crises in financial systems have demonstrated the close linkage between financial stability and the health of the economy.¹²⁸

The global financial crisis highlighted the need for financial regulations aimed at maintaining financial stability.¹²⁹ The need for regulatory change was systemic risk in capital markets.

Changes are mandated both inside and outside of the banking system in order to enhance financial stability and strengthen the market.¹³⁰ Changes to a regulatory structure occur because regulators incentivize certain discretionary behavior or mandate compliance. In this way, regulatory change is both incentive-based and information-based. The onus is on institutions to identify accurately and manage the inherent operational risks. For example, current regulations require certain

¹²⁶ See generally Filippo Occhino, *Central Bank Lending in a Liquidity Crisis*, 2 ECON. COMM. 1 (2016), https://pdfs.semanticscholar.org/1a3c/ae877f9beab47b82ec03a10fe30391dedf08.pdf?_ga=2.187037288.1176492533.1578258461-32191665.1578258461 [<https://perma.cc/XCQ2-CN3N>] (“[T]o prevent the liquidity crisis from developing into a much more costly economic and financial crisis, the central bank needs to provide liquidity to the banks that would be solvent under normal economic conditions . . .”).

¹²⁷ See Howard Davis, *Banking and the State: Changing the Social Contract*, Remarks at Barclay’s Bank 6 (2008), <http://eprints.lse.ac.uk/21466> [perma.cc/YH5C-T77C] (arguing that solution to the credit crisis is integrated regulation).

¹²⁸ One economist makes a distinction between “monetary stability” and “financial stability.” The former refers to the stability of the general price level, while the latter refers “to the stability of the key institutions and markets that go to make up the financial system.” Andrew Crockett, *Why Is Financial Stability a Goal of Public Policy?*, 82 ECON. REV. 5, 6 (1997).

¹²⁹ See generally, e.g., BASEL COMMITTEE ON BANKING SUPERVISION, BANK FOR INTERNATIONAL SETTLEMENTS, *BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS* (2010), https://www.bis.org/publ/bcbs189_dec2010.pdf [perma.cc/2JMX-M75S] (presenting the Basel Committee on Banking Supervision’s reforms on the issues of maintaining bank liquidity and resiliency).

¹³⁰ Jerome H. Powell, Chairman of the Bd. of Governors of the Fed. Res. Sys., *The Federal Reserve’s Framework for Monitoring Financial Stability: Remarks at the Economic Club of New York* (Nov. 28, 2018), <https://www.bis.org/review/r181129a.pdf> [perma.cc/5L6B-73H2].

financial institutions to create a resolution plan that becomes operational if they fail.¹³¹

Central banking is premised on maintaining financial stability. As evidenced in the subprime crisis, extreme and adverse economic conditions warrant the Federal Reserve's setting policies and adjusting interest rates to protect the banking system's capacity to meet the credit needs of households and businesses. Maintaining the integrated relationship between private sector banking and the federal government leads to a financially stable banking and well-functioning financial system.

Undoubtedly, the Federal Reserve's role in maintaining economic stability is a critical one. The interrelatedness of financial markets affects financial stability and raises concerns about aspects of financial stability and economic risks which were unknown before the subprime crisis. The linkage between systemic stability and the solvency of individual institutions affects price and monetary stability to avoid a spillover into the entire economy.

3. Monetary Stability

Monetary stability, or the strength of pricing levels, overlaps with and is distinguishable from financial stability. Monetary stability policy determines how to measure inflation, sets inflation rates, and determines the permanency of prices by measuring inflation rate or price level.¹³² On the other hand, financial stability refers to the confidence that the public must have in both financial institutions and the markets.¹³³ One of several significant linkages between the

¹³¹ The regulatory framework now requires the largest banks to have higher capital and liquidity levels and to conduct stress-tests and create living wills. Dodd-Frank Act §165, 12 U.S.C. § 5365 (2018).

¹³² As Loretta Mester explains,

Monetary policy mainly works through its ability to affect current and expected future interest rates; however, in certain circumstances, it also has the ability to affect risk-taking by investors and financial institutions, and thereby is linked to financial stability. I believe that, in general, the goals of monetary policy and financial stability are complementary. For example, price stability helps businesses, households, and financial institutions make better decisions, thereby fostering the stability of the financial system. And a stable financial system allows for more effective transmission of monetary policy throughout the economy.

Loretta J. Mester, President & Chief Exec. Officer, Fed. Reserve Bank of Clev., Five Points About Monetary Policy and Financial Stability, Sveriges Riksbank Conference on Rethinking the Central Bank's Mandate 2 (June 4, 2016), <https://www.clevelandfed.org/newsroom-and-events/speeches/sp-20160604-five-points.aspx> [<https://perma.cc/SYB8-XKX4>] (footnote omitted).

¹³³ George G. Kaufman, *Banking and Currency Crisis: A Taxonomy and Review* 52 (Loyola Univ. of Chi. Working Paper, No. 1999-12, 1999), <https://ideas.repec.org/p/dnb/staffs/48.html> [<https://perma.cc/JC5A-5VK6>].

two is that institutions remain solvent and operate without interference from regulators, and those markets operate without short-term price fluctuations.

The financial system is particularly fragile to market failure, justifying public policy intervention because of the widespread economic harm that can result. Excessive volatility in prices in financial markets has the potential to create instability at financial institutions. Yet, the instability in asset prices at financial institutions that causes investment losses does not warrant market intervention without evidence of market failure.

Banks need sound macroeconomic policies. The type of macroeconomic policies that sustain low inflation, while also encouraging economic growth, facilitate the efficient delivery of financial services and the safety and soundness of financial institutions.¹³⁴ The Federal Open Market Committee (FOMC) gives the Federal Reserve complete policy making control over the money supply.¹³⁵ Through open market operations, the Federal Reserve attempts to sustain economic growth and stabilize the money supply.¹³⁶

The banking system remains the principal way in which central banks, in general, and the Federal Reserve, specifically, implement monetary policy.¹³⁷ Financial and economic stability combine efficiency and competition. The Federal Reserve's role as a central bank is to create the needed elasticity directly and indirectly by setting the market prices and structure.¹³⁸ Flexibility in market pricing, as dictated by supply and demand conditions affect the solvency of institutions, their profitability and potentially their failure. The central bank's role

¹³⁴ For instance, “one cannot help but notice that the most severe problems in our banking and thrift industries during the 1980s stemmed from serious macroeconomic imbalances—including the accelerating inflation of the late 1970s and the costly but necessary steps to reverse that trend in the 1980s.” Governor Edward W. Kelley, Jr., *supra* note 105.

¹³⁵ See generally BD. OF GOVERNORS OF THE FED. RESERVE SYS., *Conducting Monetary Policy*, in THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS 35–41 (10th ed. 2016), https://www.federalreserve.gov/aboutthefed/files/pf_3.pdf [<https://perma.cc/327P-4KHJ>].

¹³⁶ Congress created the Federal Reserve System to reduce the risk of failures in the banking industry. Over time, the Federal Reserve's regulatory power extended to regulating the money supply. By buying and selling of government securities on the “open market,” it increases and decreases the supply of money that is available for lending. *Id.*

¹³⁷ For example, the Federal Reserve regulates banks and the money supply through reserve requirements, which control banks' market participation. Specifically, the Federal Reserve, and other central banks, control short-term interest rates by manipulating the required reserves to satisfy banks' demand. Banks can demand reserves only when they meet reserve requirements and access requires meeting funds management rules. See 12 U.S.C. 461(b)(2) (2018) (requiring depository institutions to maintain specific levels of reserves).

¹³⁸ For more on the role of central banks, see generally Mester, *supra* note 132, at 13–14 (making the point that “structural resiliency tools” can help central banks ensure stability).

is to permit market flexibility in pricing, while mediating price instability so that it does not damage consumer confidence and economic activity.¹³⁹

Central banking, arguably, creates a social contract between the banking system, regulators, and the government. As discussed below, the payments system is a crucial part of financial infrastructure used to facilitate financial stability and to mitigate financial crises by reducing settlement risks. The inter-linkages with financial markets and the Federal Reserve's role in monitoring price stability is an acknowledged relationship between private sector banking and the federal government. That critical involvement also establishes the public nature of banks and banking and underlies the argument that access to banking is a public good.¹⁴⁰

B. Financial Intermediation as a Public Function

1. Financial Intermediation

The financial and economic viability of consumers depends on navigating the increasingly complex banking environment.¹⁴¹ Banks, historically, are the leaders in financial intermediation, using deposit accounts to fund consumer and commercial loans through maturity transformation. Understanding how privately owned banks use public resources in financial intermediation to make profits raises fundamental issues about who should have access to banks.

Central banks, such as the Federal Reserve, license banks to create money.¹⁴² They also are responsible for payments system infrastructure used for check clearing, and holding banks' reserve accounts.¹⁴³ When deposit-withdrawal

¹³⁹ For more on the role of central banks, see BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 135, at 23–32 (describing how the federal reserve conducts monetary policy to stabilize the economy and level of prices).

¹⁴⁰ See Robert C. Hockett & Saule T. Omarova, "Special," *Vestigial, or Visionary? What Bank Regulation Tells Us About the Corporation—and Vice Versa*, 39 SEATTLE U. L. REV. 453, 478 (2016) (describing the specialness of private banks as public franchises dispensing public credit); see also Piotr Masiukiewicz, *Doctrine of Public Good in Banking Versus State Intervention* 2–3 (Institute of Econ. Research Working Paper No. 38.2014, 2014), http://www.badania-gospodarcze.pl/images/Working_Papers/2014_No_38.pdf [<https://perma.cc/WCU9-DYXJ>] (arguing that the degree of state regulation of banking provides evidence that it is treated as a public good).

¹⁴¹ Lawrence B. Lindsay, *The CRA as a Means to Provide Public Goods*, in REVISING THE CRA: PERSPECTIVES ON THE FUTURE OF THE COMMUNITY REINVESTMENT ACT 160, 165 (Prabal Chakrabarti et al. eds., 2009), https://www.frbsf.org/community-development/files/cra_means_provide_public_goods.pdf [<https://perma.cc/PGQ4-J58P>].

¹⁴² See BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 135, at 41–42 (outlining the tools central banks use to achieve the targeted federal funds rate).

¹⁴³ See Jaromir Benes & Michael Kumhof, *The Chicago Plan Revisited* (Int'l Monetary Fund, Working Paper No. 12/202, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12_202.pdf

demands exceed the amount in the central bank reserve account, the bank can make an overnight interbank loan from the central bank or other banks to meet the reserve requirement.¹⁴⁴ The back-up liquidity from the central bank allows banks to both allocate credit through loans and facilitate payments through the payments system.¹⁴⁵ The same functions that arguably make banks “special,” back-up liquidity and the payments system, are key to how they dispense credit.

Banks are the intermediaries of borrowers and savers. They provide payment services, guarantee deposits, and create credit, using other people’s money. These functions, also essential to a viable economy, demonstrate the importance of banking to the economy. While consumers appear to voluntarily choose fringe banks and their products and services, lack of access to the formal banking economy creates challenges and generates additional concerns. Specifically, failure to participate in the formal banking economy means forsaking the primary way to enter the financial mainstream. Using the formal banking economy allows consumers to build wealth, acquire assets, and establish credit. If access to the formal banking economy is not widened, LMI consumers are not given the benefit of these public policy choices designed for the entire society’s benefit.¹⁴⁶

a. The Theory of Public Goods

A public good is one that is needed for the public welfare, but is not provided by the private marketplace because it is not profitable.¹⁴⁷ In economic

[<https://perma.cc/728M-N5BG>] (discussing how the Chicago Plan required 100% backing of deposits by government-issued money to eliminate bank runs); Ulrich Bindseil, *The Operational Target of Monetary Policy and the Rise and Fall of Reserve Position Doctrine* (European Cent. Bank, Working Paper No. 372, 2004), <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp372.pdf> [<https://perma.cc/8MPD-J52Y>]; Piti Disyatat, *Monetary Policy Implementation: Misconceptions and Their Consequences 2–4* (Bank for Int’l Settlements, Working Paper No. 269, 2008), <https://www.bis.org/publ/work269.pdf> [<https://perma.cc/EN7C-RQ7L>].

¹⁴⁴ Banks facing a liquidity crisis that are members of the Federal Reserve may borrow from the Fed’s Discount window. See Federal Reserve Act, 12 U.S.C. 248(i)-(j) (2018). Interbank lending among insured depository institutions is regulated under 12 U.S.C. §371b-2, and includes “credit and liquidity risks, including operational risks, related to intraday and inter-day transactions.” 12 C.F.R. §206.2(d).

¹⁴⁵ See IRVING FISHER, 100% MONEY AND THE PUBLIC DEBT 15–17 (2009) (ebook) (discussing the instability of demand deposits as a source of loans).

¹⁴⁶ See, e.g., 12 U.S.C. § 24 (2018) (describing how bank investments may be accepted as public funds); see also Michael P. Malloy, *Principles of Bank Regulation* 496 (3rd ed. 2011) (discussing whether the Community Reinvestment Act was effective in increasing the availability of banking services to low-income communities).

¹⁴⁷ See Lindsay, *supra* note 141, at 160 (discussing the concept of a public good in the context of the CRA).

terms, a “good” must be something of value which is productive.¹⁴⁸ In order for a good to be characterized as a public good, it must have two specific characteristics: (1) non-rivalrous and (2) non-excludable.¹⁴⁹ To be a non-rivalrous good, anyone should be able to consume the good without a cost to others. To be a non-excludable good, no one can be excluded from consuming it. The “publicness” of the good means that there can be simultaneous availability allowing more than one individual access to the good.¹⁵⁰

While government creates most public goods, such as first responders and public schools, the government can sanction private parties to create goods for public consumption.¹⁵¹ When public goods are created by a private entity, the inherent conflict is the need for an unlimited supply. The underlying competitiveness of the private market is at odds with the unlimited availability that is the very nature of public goods.¹⁵²

Economists disagree on whether public goods are more efficiently produced in the public sector. One theory posits that government produced public goods are the most efficient.¹⁵³ It is premised on the idea that market failure has resulted in non-production and government expenditures are needed to produce the good.¹⁵⁴ The other theory argues that private production of public goods may be more efficient. The premise is that market preferences may be undervalued, yet the goods still needed.¹⁵⁵ The distinction is made to separate the justification for why a good is needed and the public expenditure of funds from whether a public or private party produces the good.¹⁵⁶ Indeed, maximizing the public welfare should be sufficient justification for the support and legitimacy of public goods.

¹⁴⁸ Piotr Masiukiewicz, *Doctrine of Public Good in Banking Versus State Intervention* 3 (Inst. of Econ. Res. Working Paper No. 38, 2014), http://www.badania-gospodarcze.pl/images/Working_Papers/2014_No_38.pdf [<https://perma.cc/8SPS-F69S>].

¹⁴⁹ J. M. BUCHMAN, *THE DEMAND AND SUPPLY OF PUBLIC GOODS* 49 (1968).

¹⁵⁰ Joseph P. Kalt, *Public Goods and The Theory of Government*, 1 *CATO J.* 565, 567 (1981).

¹⁵¹ Randall G. Holcombe, *A Theory of the Theory of Public Goods*, 10 *REV. AUSTRIAN ECON.* 1, 2–4 (1997).

¹⁵² See generally Paul A. Samuelson, *The Pure Theory of Public Expenditures*, 36 *REV. ECON. & STAT.* 387 (1954).

¹⁵³ Holcombe, *supra* note 151, at 4.

¹⁵⁴ See generally *id.*

¹⁵⁵ James M. Buchanan, *Public Finance and Public Choice*, 28 *NAT'L TAX J.* 383, 386 (1975); see also Holcombe, *supra* note 151, at 12 (giving examples of private production of goods which are nonexcludable, like public goods).

¹⁵⁶ A different economic perspective completely negates the public goods theory and instead argues that the contractarian model of government is preferable. By contrasting Rawls' presumed social contract created by consensus with Nozick's minimalist state intervention and Buchanan's “constitutional contract,” political economist Scott Gordon posits that there are not clear entitlements to the public benefits of society, but instead they evolve as needs develop. See Scott Gordon, *The New Contractarians*, 84 *J. POL. ECON.* 573–90 (1976)

b. Banking as a Public Good

The idea of public goods in the financial sector is not a novel one. Economists have justified classifying banking as a public good based on public trust,¹⁵⁷ the services banks provide,¹⁵⁸ a coherent financial regulation and supervision framework,¹⁵⁹ protection of the banking system and stability during a financial crisis,¹⁶⁰ the “Too Big to Fail Doctrine”,¹⁶¹ and the social contract between citizens and the government.¹⁶² What is a more novel, but

(reviewing several contractarian models of government); *see generally* JOHN RAWLS, A THEORY OF JUSTICE (1971) (articulating a theory of justice as fairness, where fairness is defined by the principles that self-interested individuals would agree to if they were ignorant of their own political identities). Under this approach, the government contracts or agrees to provide goods that are needed for the public’s benefit. The exchange is mutually beneficial—governmental institutions protect citizens by providing needed goods and citizens fund the government and elect its leaders. The government involvement lends legitimacy to institutions by creating processes and rules that are fair and collectively beneficial. The disincentive to encourage private sector development is that it would limit government profits. *See also* Holcombe, *supra* note 151, at 12–15 (describing a positive model of government, where the government produces goods for its citizens who in turn provide wealth for the government).

¹⁵⁷ E. Gerald Corrigan, President of the Fed. Reserve Bank of N.Y., Remarks before the 7th International Conference of Banking Supervisors in Cannes, France (Oct. 8, 1992), in E. Gerald Corrigan, *Challenges Facing the International Community of Bank Supervisors*, FED. RES. BANK N.Y. Q. REV., Autumn 1992, at 1, 6, https://www.newyorkfed.org/medialibrary/media/research/quarterly_review/1992v17/v17n3article1.pdf [<https://perma.cc/8U9B-Y2TR>].

¹⁵⁸ J.K. SOLARZ, FINANCIAL SYSTEM RISK MANAGEMENT 159 (2008).

¹⁵⁹ Donato Masciandaro & Marc Quintyn, *The Evolution of Financial Supervision: The Continuing Search For The Holy Grail*, in 50 Years of Money and Finance: Lessons & Challenges 263, 272 (Niels C. Thygesen et al., eds., 2013), <http://EconPapers.repec.org/RePEc:erf:erfft:l> [<https://perma.cc/9UYE-TVW8>].

¹⁶⁰ *See* Masiukiewicz, *supra* note 140, at 2 (“State intervention on a great scale during the subprime crisis indicates that the governments and international institutions treat banking as a special good.”); *Testimony of Chairman Alan Greenspan on H.R. 10, the Financial Services Act of 1998, Before the Senate Committee on Banking, Housing, and Urban Affairs*, THE FED. RES. BOARD (June 17, 1998), <https://www.federalreserve.gov/boarddocs/testimony/1998/19980617.htm> [<https://perma.cc/ZGE2-BDMX>] (“[D]evelopments in our financial system—especially, but not solely in our banking system—can have profound effects on the stability of our whole economy”); KAREL LANNOO, COMPARING E.U. AND U.S. RESPONSES TO THE FINANCIAL CRISIS 6 (2010) (discussing the management of OTC derivatives by EU and American central banks, and observing that, “Both regulators aim at ensuring financial stability for the largest global financial market”).

¹⁶¹ G. G. Kaufman, *Banking and Currency Crisis: A Taxonomy and Review*, 9 FIN. MARKETS, INST. & INSTRUMENTS 69, 110 (2000).

¹⁶² *See* HOWARD DAVIES, LONDON SCH. OF ECON. ONLINE, BANKING AND THE STATE: CHANGING THE SOCIAL CONTRACT 6 (2008), <http://eprints.lse.ac.uk/21466/1/Banking%26theState.pdf> [<https://perma.cc/6YL3-4R7P>] (arguing that central banks’ involvement in

less appealing, economic policy argument, is that banks have an economic responsibility to the public. That responsibility is two-fold: (1) protecting depositors and investors and (2) preserving systemic stability. Prudential regulation is justified given the key role the financial system plays in the economy.¹⁶³ The crux of the economic responsibility argument is based on the indisputable role that modern banking plays in maintaining financial stability and the specific role that central banks play in systemic stability.

Banking is a public-private partnership and central banks have a myriad of regulatory and operational functions. Central banks are the wholesalers of banking services with commercial banks providing retail services. Central banks create safety nets for financial institutions using capital to maintain the solvency of individual banks, a banking group, or as during the crisis, other entities in the financial system. Specifically, in the United States, deposit insurance and access to the discount window are benefits that banks receive from the federal government without which they would be unable to operate.

First, the “public good” role of the financial system, as the pivot of the economy, justified that the prudential regulation framework be complemented by an intrusive supervisory framework. Deposit insurance provides banks with a significant advantage. Banks are able to attract customers because of the imprimatur of deposit insurance. The complex supervisory system monitors institutions’ risk-taking and lack of transparency to the depositors’ advantage. Customers do not have to determine the soundness of the institution nor monitor its performance for safety. The governance and risk management of individual financial institutions, both of which impact creditworthiness, is monitored by regulators.¹⁶⁴ The system of regulation and supervision reduces customers’ costs of borrowing because banks have set capital requirements and limitations on lending, both of which are returned to the customer.

Central banks serve as regulators of monetary policy. They have macro-economic management responsibilities. As Lenders of Last Resort (LLR), central banks prevent panic by providing credit to shore up institutions facing a liquidity crisis.¹⁶⁵ These economic tools used to shore up banks all come from the public fisc or money supply. They are responsible for monetary policy and the workings of the financial system as a whole.

the global liquidity crisis changed the expectations of financial institutions and the banks given the poor financial performance of many financial institutions).

¹⁶³ See discussion *supra* Part II.

¹⁶⁴ Robert J. Dijkstra, *Accountability of Financial Supervisory Agencies: An Incentive Approach*, 11 J. BANKING REG. 115, 115–28 (2010).

¹⁶⁵ Murray N. Rothbard, *The Origins of the Federal Reserve*, 2 Q.J. AUSTRIAN ECON. 3, 3, 39 (1999).

Public involvement through financial assistance, restructuring bonds, tax relief and nationalization of financial institutions are all among the ways that central banks broadly protect against systemic failure.¹⁶⁶

Central banks have an operational function regarding the payment system. The central bank's payments infrastructure facilitates payment between the central bank, privately owned banks, and banks' borrowers. Banks' settlement accounts with central banks can receive funds from the central bank in case withdrawals exceed actual deposits. Privately drawn checks clear through the payment system of one of the regional Federal Reserve Banks.¹⁶⁷ Banks make loans based on a fraction of the deposits they hold. Banks are required to maintain a fraction of their deposit liabilities in a reserve account. The lending bank must have sufficient liquid funds in its account to cover withdrawals as well the reserve requirement.¹⁶⁸ If the bank's account will be insufficient to maintain the reserves after the overnight withdrawals, the bank must either borrow from other banks or from the central bank. Inter-bank lending boosts confidence in the banking system by ensuring that the necessary funds are available. Customers are reassured that their deposits are safe, thereby reducing the risk of a bank run. Moreover, this fiscal undergirding allows banks to profit from and make loans.¹⁶⁹

While the proposals for financial inclusion can occur within the Federal Reserve's traditional mandates of stability and integrity of the financial system, the next Section examines how the regulatory system thus far has ineffectively addressed financial inclusion.

2. The Existing Regulatory Response

In the U.S., several changes to the banking regulatory structure are targeted to provide access to those who face illegal discrimination. The Community Reinvestment Act (CRA), community development credit unions (CDCUs), and community development financial institutions (CDFIs) can be characterized as monitoring and providing access to credit for those who have faced historical discrimination in credit markets. Similarly, the recent postal banking proposal is specifically characterized

¹⁶⁶ See generally Michael Diekmann. *The Swing to the State Must Not Go Too Far*, FIN. TIMES (Dec. 12, 2008), <https://www.ft.com/content/30c40f2c-cf62-11dd-abf9-000077b07658> [<https://perma.cc/P2NH-B7BN>] (discussing banks' role in the economy and arguing that the debate is not if central banks should intervene, but how they will intervene).

¹⁶⁷ See BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 135, at 119 (explaining how the Federal Reserve collects checks deposited by banks and returns unpaid checks to the bank).

¹⁶⁸ See *id.* at 41–42 (describing the percentage of deposits that commercial banks must hold as reserves).

¹⁶⁹ Hockett & Omarova, *supra* note 140, at 480.

as promoting financial inclusion.¹⁷⁰ As discussed below, the limited focus of these programs does not remedy the concerns noted above.

a. The Community Reinvestment Act (CRA)

The Community Reinvestment Act (CRA), enacted in 1977, is the federal statute that mandates that a bank serve its entire geographical community. The statute has a limited purpose of increasing real estate lending.¹⁷¹ It requires federal banking regulators to encourage financial institutions to help meet the credit needs of the communities in which they do business, including LMI neighborhoods.¹⁷² Designed to prevent and detect discrimination, the CRA prohibits two well-established practices by financial institutions: disinvestment and redlining.

Disinvestment occurs when depository institutions take deposits from a community but fail to extend credit to credit-worthy members of that community.¹⁷³ Redlining is geographic discrimination. The historical practice was for lenders to actually or figuratively draw a red line on a map around the areas of their city, considered “poor credit risk” neighborhoods, which often were black, lower-income, or ethnic.¹⁷⁴ Lending standards for these identified

¹⁷⁰ See Off. of Inspector Gen., U.S. Postal Serv., *Providing Non-Bank Financial Services for the Underserved* i (White Paper No. RARC-WP-14-007, Jan. 27, 2014), https://www.uspsig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-007_0.pdf [<https://perma.cc/N89A-Y4SR>] (outlining a proposal for using postal branches to provide “non-bank financial services to those whose needs are not being met by the traditional financial sector”).

¹⁷¹ Under the service test, financial institutions provide and fund financial literacy program. 12 C.F.R. § 7.1021.

¹⁷² Nellie R. Santiago, et al., *Turning David and Goliath into the Odd Couple: How the New Community Reinvestment Act Promotes Community Development Financial Institutions*, 6 J.L. & POL'Y 571, 573 (1998). The FDIC, the Federal Reserve, and the OCC each supervise banks that have CRA obligations. The FDIC supervises FDIC-insured, state-chartered banks and savings banks that are not members of the Federal Reserve. The Federal Reserve supervises state-chartered banks that are members of the Federal Reserve System. The OCC supervises national banks. 12 U.S.C. § 2903 (1988).

¹⁷³ Specifically, the Act requires depository institutions to “demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business.” 12 U.S.C. § 2901(a)(1) (2018). For more on divestment, see Gary M. Swidler, *Making the Community Reinvestment Act Work*, 69 N.Y.U. L. REV. 387, 393 (1994) Gary Swidler, *Making the Community Reinvestment Act Work*, 69 N.Y.U. L. REV. 387, 393 (1994) (defining disinvestment as “when depository institutions take in capital, usually in the form of deposits, from one community and then use the funds to make loans outside that community”).

¹⁷⁴ The Congressional sponsor of the CRA described the practice as:

“[Taking] deposits from a community and instead of reinvesting them in that community, they will invest them elsewhere, and they will actually or

areas were different, with credit often non-existent because of those strict policies.¹⁷⁵

To combat these practices, the CRA requires the evaluating regulatory agency “to assess the institution's record of meeting the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution.”¹⁷⁶ The CRA rating, which is an annual assessment done by the banking regulators, is taken into account when there is a bank merger or acquisition. At that time, regulators evaluate how the institution has met the “credit needs” of the community.¹⁷⁷

The CRA has its critics. Initial criticisms focused on the vague language¹⁷⁸ and the indirect enforcement.¹⁷⁹ Institutions found it difficult to interpret their responsibilities on “meet[ing] the credit needs of local communities.”¹⁸⁰ The statute was amended to include three tests, (1) lending, (2) investment, and (3) service, making obligations less vague.¹⁸¹ Communities found the statutes’ implementation ineffective.¹⁸² The CRA is also controversial because banks

figuratively draw a red line on a map around the areas of their city, sometimes in the inner city, sometimes in the older neighborhoods, sometimes ethnic and sometimes black”

123 Cong. Rec. 17,630 (daily ed. June 6, 1977) (statement of Sen. Proxmire).

¹⁷⁵ Lenders restricted lending in these areas by having exorbitant interest rates and loan fees. See Jonathan P. Tomes, *The “Community” in the Community Reinvestment Act: A Term in Search of a Definition*, 10 ANN. REV. BANKING L. 225, 227–28 (1991) (discussing the practice of justifying high interest rates that in effect restricted lending in certain neighborhoods).

¹⁷⁶ 12 U.S.C. § 2903(a)(1) (2018).

¹⁷⁷ 12 U.S.C. § 2901 (2018).

¹⁷⁸ See Allen Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, but Strengthened Federal Enforcement is Needed*, 20 FORDHAM. URB. L.J. 203, 297 (1993) (critiquing the CRA as vague).

¹⁷⁹ See Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 202–93 (1993) (critiquing the CRA ‘s burdensome compliance costs).

¹⁸⁰ A. Brooke Overby, *The Community Reinvestment Act Reconsidered*, 143 U. PA. L. REV. 1431, 1437–39 (1995) (describing the Act's language as vague, particularly “credit need,” which could refer to a borrower’s ability to pay a risk-adjusted interest rate, or a borrower’s ability to only afford a rate that did not reflect its risk of default); see also Jonathan A. Neuberger & Ronald H. Schmidt, *A Market-Based Approach to CRA*, ECON. LETTER, 1994, no. 21, at 1, 1 (arguing that “[t]he language of the CRA statute was intentionally vague, balancing a social policy goal of encouraging banks to lend in lower income areas with regulators' concerns about bank safety and soundness”).

¹⁸¹ 12 C.F.R. §§ 228.22, 228.23, 228.24 (2019).

¹⁸² See Griffith L. Garwood & Dolores S. Smith, *The Community Reinvestment Act: Evolution and Current Issue*, 79 FED. RES. BULL. 251, 251 (1993) (explaining that “many community and consumer groups...believe that financial institutions are not doing enough to help meet the credit needs of residents and businesses in low- and moderate-income

argue that it can become an unfair bargaining tool, even promoting risky investments.¹⁸³

Despite these controversies, the CRA has been successful to the extent that it incentivized local financial institutions to reevaluate lending opportunities in underserved areas.¹⁸⁴ As discussed below in Part III, the CRA might prove useful to measure banks' effectiveness in financial inclusion efforts.

b. Community Development Credit Unions (CDCUs)

CDFIs were established with the aim of promoting economic revitalization by providing low-income communities with access to essential financial services.¹⁸⁵ In 1994, Congress passed the Riegle Community Development and Regulatory Improvement Act.¹⁸⁶ One of the many essential

areas"); *see also* Michael S. Barr, *Credit Where it Counts: The Community Reinvestment Act and its Critics*, 80 N.Y.U. L. REV., 513, 565 (2005) (noting that the CRA was generally considered ineffective during the 1980s due to "inadequate regulatory attention"); Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349, 349 (1993) (arguing that "the CRA may actually decrease the level of investment in low-income and moderate-income communities, while imposing enormous compliance burdens on banks").

¹⁸³ *See* Michael Klausner, *Market Failure and Community Investment: A Market-Oriented Alternative to the Community Reinvestment Act*, 143 U. PA. L. REV. 1561, 1565 (1995) (arguing that the "asymmetry of information" on a borrower's risk of default between banks and the borrower may discourage banks from lending to LMI communities).

¹⁸⁴ Some studies have shown increased lending to underserved communities since the CRA's enactment, though it is difficult to distinguish how much of the increase was attributable to just the CRA or whether the CRA-induced lending has been overall profitable. One study attributed the statute's design with the difficulty of assessing whether the incentivized lending that of was profitable. *See generally, e.g.*, Darryl E. Getter, Cong. Research Serv., R43661, *The Effectiveness of the Community Reinvestment Act 2*, 9 (2020), <https://crsreports.congress.gov/product/pdf/R/R43661> [<https://perma.cc/L83V-7P8A>]; Sumit Agarwal et al., *Did the Community Reinvestment Act (CRA) Lead to Risky Lending?* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 18609, (2012), <http://www.nber.org/papers/w18609.pdf> [<https://perma.cc/V942-479K>]). While the CRA was not the cause of the subprime crash, critics argue that it contributed to the housing bubble and the general expansion of credit during the 1990s. *See* Lindsay, *supra* note 141, at 164.

¹⁸⁵ Beginning in the 1880s, when the first minority-owned banks focused on low-income areas, community organizations developed CDFIs to provide needed financial services. From the creation of credit unions in the 1930s and 1940s, community development corporations beginning in the 1960s and 1970s, and to the more recent emergence of non-profit loan funds in the 1980s, the predecessors to CDFIs sought to better the conditions in these economically underserved markets. *See generally* U.S. Dep't of the Treasury, *What Are CDFIs?* (n.d.), https://www.cdfifund.gov/Documents/CDFI_infographic_v08A.pdf. [<https://perma.cc/K9ZN-RZHW>] (providing a brief history of CDFIs).

¹⁸⁶ Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, 66 Stat. 2160 (1994) (codified as amended at 12 U.S.C. § 470 (2018)).

functions of this legislation was the establishment of the Community Development Financial Institutions Fund.¹⁸⁷ The Community Development Financial Institutions Fund procures funding through the United States Department of the Treasury in order to invest in and assist CDFIs by enhancing their liquidity.¹⁸⁸

CDFIs come in many forms, the most common being CDCUs, and Community Development Loan Funds.¹⁸⁹ CDCUs are generally established in order to provide fairly priced loans, as well as savings and checking accounts for their low-income members.¹⁹⁰ In addition, CDCUs serve the essential function of bridging the gap between low- and moderate-income borrowers and traditional commercial loans.¹⁹¹

At first blush, CDCUs purport to serve as an effective means of integrating marginalized individuals in the United States into the formal banking system. This approach to financial inclusion, however, has not been universally accepted, and many CDCUs have struggled to maintain economic viability.¹⁹² Approximately 50 percent of start-up CDCUs failed in the 1990s, which can be attributed to several factors including: “under-qualified management and boards; inadequate capital, liquidity, bookkeeping, and staffing; limited range of services; inadequate economies of scale; absence of collaboration with community partners; and inadequate use of existing

¹⁸⁷ *Id.* § 120.

¹⁸⁸ 12 U.S.C. § 4701 (2018).

¹⁸⁹ Christopher Jordan Heisen, Comment, *Community Development Lite: An Economic Analysis of the Community Development Financial Institutions Act*, 39 HOW. L.J. 337, 348 (1995).

¹⁹⁰ A CDCU has a specific focus on the economic well-being of LMI members. . . Robert W. Shields, *Community Development Financial Institutions and the Community Development Financial Institutions Act of 1994: Good Ideas in Need of Some Attention*, 17 ANN. REV. BANKING L. 637, 650 (1998).

¹⁹¹ CDCUs in some areas may help those whose access to credit is limited by income, but not enough to qualify for government subsidies:

In addition to serving areas where no other lending institutions exist, CDCUs serve a market niche that other types of lending institutions and programs do not. For example, CDCUs serve as a place where low- and moderate-income people can pool their savings and receive loans that they otherwise would not be able to receive. Many of the low-and moderate-income borrowers’ income is too high to qualify for government subsidized loan programs yet not high enough for them to qualify for traditional commercial loans. They are, however, able to obtain credit via CDCUs.

Id.

¹⁹² See Charles D. Tansey, *Community Development Credit Unions: An Emerging Player in Low Income Communities*, BROOKINGS (Sept. 1, 2001), <https://www.brookings.edu/articles/community-development-credit-unions-an-emerging-player-in-low-income-communities/> [<https://perma.cc/5V XT-4J65>] (highlighting the multitude of reasons for CDCUs’ widespread failure).

programs and financial institutions to support their efforts.”¹⁹³ Chartering a CDCU, similar to a bank, requires meeting prerequisite conditions. The organizational plan for a CDCU must show that it will be economically viable. Before obtaining a charter, the organization must show that the proposed combination of members, deposit, institutions and social investors will produce a sustainable flow of capital.¹⁹⁴

The failure of CDCUs to rectify the issue of financial exclusion can be attributed to their weak financial performance when compared to that of banks.¹⁹⁵ Between the years of 2005 and 2010, the operating expense ratio of these credit unions was 36 percent higher than the industry, and the ratio of net operating expenses to average assets was 27 percent higher for CDFI credit unions.¹⁹⁶ Furthermore, CDFI credit unions have experienced declining earnings and rising delinquency rates, which are higher than the credit union industry as a whole.¹⁹⁷

Finally, CDCUs are burdened with the requirement of maintaining self-sufficiency in order to remain operational. As a result of this burden, and without the margin for error that some of their more conventional counterparts have, CDCUs often cannot engage in the very high-risk financing that they were established to facilitate.¹⁹⁸ Currently, there exist approximately 237 CDCUs in the United States, in comparison with the 4518 commercial banks in the United States.¹⁹⁹ CDUs, alone, have not addressed the problem of financial exclusion, making the discussion below of postal banking, a well-considered alternative at one time²⁰⁰

¹⁹³ *Id.*

¹⁹⁴ See Lehn Benjamin et al., *Community Development Financial Institutions: Current Issues and Future Prospects*, 26 J. URB. AFF. 177, 189 (2004) (describing regulations to which CDCUs must adhere in order to offer federal depository insurance).

¹⁹⁵ *Historical Trends as of December 31, 2019*, FDIC, <https://www.fdic.gov/bank/statistical/stats/2019dec/fdic.pdf> (last visited Apr. 4, 2020).

¹⁹⁶ NAT'L. CREDIT UNION ADMIN., 2011 ANNUAL REPORT 142 (2012), <https://www.ncua.gov/Legal/Documents/Reports/AR2011.pdf> [<https://perma.cc/FET8-F65S>].

¹⁹⁷ *Id.* at 76.

¹⁹⁸ For example, regulators have allowed relatively few CDCUs to make small-business loans because of the higher risk involved in such lending. Neither banks nor credit unions can make equity investments in start-up businesses (although non-regulated bank affiliates may do so). *Id.*

¹⁹⁹ See *Membership Directory*, INCLUSIV, <http://www.cdcu.coop/membership/membership-directory/> [<https://perma.cc/B6C2-28NF>] (last visited Apr. 4, 2020) (listing 247 CDCUs in its national Membership Directory.); *Statistics at a Glance*, FED. DEPOSIT INS. CORP., <https://www.fdic.gov/bank/statistical/stats/2019dec/fdic.pdf> [<https://perma.cc/RGG7NGYE>] (last visited Apr. 4, 2020).

²⁰⁰ See 2017 FDIC SURVEY, *supra* note 2, at 1 (“The unbanked rate in 2017 declined to the lowest level since the survey began in 2009. Since the survey was last administered in 2015, the unbanked rate has fallen by 0.5 percentage points.”).

c. The Postal Banking Proposal

Similarly, the recent proposal calling for postal banking in the United States recognizes the need to support financial inclusion as well as the absence of a strong competitive alternative.²⁰¹ In 2014, the U.S. Postal Service Office of Inspector General released a white paper proposing that the Postal Service provide non-bank financial services to individuals who are underserved by the traditional financial sector.²⁰² The white paper posits that individuals remain unbanked or underbanked for a myriad of reasons, many of which Post Offices are best situated to address.²⁰³ For example, the network of post offices, stations, and branches is spread out across the country, to include “banking deserts” and geographical areas where individuals have little or no access to banks or other financial institutions.²⁰⁴ The proposal cites to Americans’ trust and familiarity with the postal brand and the importance of trust in the financial services sector, particularly when considering the experiences of unbanked and underbanked individuals in dealing with fringe banking systems or untrustworthy financial service providers.²⁰⁵ Further, the post office environment, policies, and procedures are less intimidating than that of banks, and many Americans, including the poor, are familiar with their location, the processes, and in some cases the Post Office employees.²⁰⁶

²⁰¹ See U.S. POSTAL SERV., OFF. OF INSPECTOR GEN., PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED i (2014) [hereinafter PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED] (contending that “[p]ostal organizations have an unmatched ability to reach consumers from diverse backgrounds); cf. Eric Grover, *Return to Sender: Here’s What’s Wrong With Postal Banking*, AM. BANKER (May 17, 2018), <https://www.americanbanker.com/opinion/return-to-sender-heres-whats-wrong-with-postal-banking> [https://perma.cc/84DY-CR24] (arguing against the use of postal banking). See generally, Mehrsa Baradaran, *It’s Time for Postal Banking*, 127 HARV. L. REV. F. 165, 174–75 (2014) (contesting that the postal banking proposal will result in the predicated increased revenues because small dollar loans are not profitable).

²⁰² As stated in the white paper,

According to the FDIC, certain segments of the population are disproportionately underserved, including lower-income, black, and Hispanic households, as well as people under the age of 25. However, white households still account for half of the underserved. Geographically, the underserved live throughout the country. However, they are over-represented in the South, where poverty is more prevalent, and in inner cities.

PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED, *supra* note 201, at 3.

²⁰³ *Id.* Consumers are unbanked for procedural reasons, e.g., violation of bank rules and/or requirements, and cultural reasons, e.g., don’t feel comfortable using banks.

²⁰⁴ Baradaran, *supra* note 201, at 167–68.

²⁰⁵ PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED, *supra* note 201, at 6.

²⁰⁶ Baradaran, *supra* note 201, at 169.

The proposal of a postal banking system is not a revolutionary concept in the United States. In 1910, Congress established a Postal Savings System in order to establish a formal savings system for immigrants who were accustomed to saving at their local Post Offices in their home countries and to integrate the unbanked poor into the formal banking system.²⁰⁷ The nationwide program was designed to encourage savings by providing a secure place to make deposits.²⁰⁸ By 1947, the Postal Savings System had accumulated approximately \$3.4 billion in savings deposits from 4 million customers.²⁰⁹ Eventually, by 1964, the Postal Savings System saw a decline in usage and deposits declined, dropping to \$416 million.²¹⁰ The system was eventually discontinued in 1967 due to the decline in its usage.²¹¹

The success of the Postal Savings System and need for a solution to integrate unbanked and underbanked Americans has sparked a proposal for its resurgence in today's financial services sector. Currently, the United States Postal Service provides customers with limited financial services such as money orders.²¹² The proposal would increase customers' access to those services by broadening the scope of services provided and establishing a public bank, which would also take deposits and make small loans.²¹³ An example of a payment service offered by the postal banking proposal is the Postal Card.²¹⁴ The Postal Card would function as a prepaid card, allowing to load onto the funds onto the card and withdraw cash at ATMs, pay bills online, and transfer funds.²¹⁵ Furthermore, the

²⁰⁷ The Postal Savings System garnered support within the formal banking sector. "Although bankers first viewed the Postal Savings System as competition, they later were convinced that the Postal Savings System brought a considerable amount of money out of hiding from mattresses and cookie jars." *Postal Savings System*, U.S. POSTAL SERV. (July 2008), <http://about.usps.com/who-we-are/postal-history/postal-savings-system.pdf> [<https://perma.cc/9KPE-YMJ8>].

²⁰⁸ This program was created and geared to recent immigrants and the unbanked poor and at the end of the first year, there was a total of \$20 million in deposits. Baradaran, *supra* note 201, at 170.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Sending Money Orders*, U.S. POSTAL SERV., <https://www.usps.com/shop/money-orders.htm> [<https://perma.cc/VA8K-VVRE>] (last visited Oct. 22, 2018).

²¹³ See PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED, *supra* note 201, at i–ii, 9–17.

²¹⁴ *Id.* at 10.

²¹⁵ According to the white paper,

With the development of highly secure identity verification systems and partnerships with government at the local, state, and federal levels, the cards also could send or receive tax payments and refunds, as well as handle other government-to-citizen or citizen-to-government payments.

Postal Service can partner with traditional financial institutions to provide “an interest-bearing savings feature” on the Postal Card.²¹⁶ would allow the underserved to develop a savings system to adequately prepare for a crisis or save money for a large purchase.²¹⁷

Opponents of the postal banking proposal assert that simply utilizing post offices to provide financial services to unbanked and underbanked Americans is not the comprehensive program needed to effectively remedy financial exclusion.²¹⁸ These opponents assert that postal banking would not provide the financial education and planning assistance that families in underrepresented communities need in order to maintain long term financial stability.²¹⁹

As discussed below, the adverse impact of the recent financial crisis on large segments of the population raises questions about the objectives of financial sector policy. Specifically, the issue becomes whether the purpose of financial sector public policy is to ensure fiscal stability as well as equity.

III. FINANCIAL SECTOR PUBLIC POLICY AND FINANCIAL INCLUSION

Two failures—banking concentration and the low quality of the fringe banking industry (microfinance) institutions have created financial exclusion. Bringing fringe bank consumers into the banking mainstream requires that the financial impediments that banks face in offering those accounts be resolved. Banks need to reduce the agency and transaction costs involved in offering transaction accounts to maintain a competitive advantage. This Part proposes allowing agent or branchless banking to operate in commercial establishments as a way to increase access points to the formal financial system for fringe bank consumers. The recommendation would help prevent predatory practices in the provision of financial services and make supervision of the financial inclusion activities proportionate to the risks, rather than imposing onerous regulatory costs on the banking sector.

Such a product would not only help reduce the government costs associated with cash and check payments, it also would help fulfill the goal of bringing the underserved into the mainstream financial fold. The funds on Postal Cards could be covered by the FDIC insurance of a partner bank.”

PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED, *supra* note 201, at 10.

²¹⁶ *Id.* at 11.

²¹⁷ *Id.*

²¹⁸ *See, e.g.*, Sara Sternberg Greene, *The Bootstrap Trap*, 67 DUKE L.J. 233, 295 (2017).

²¹⁹ *Id.*

A. The Agent Banking Proposal

Consumers who obtain financial services outside the mainstream banking system may not receive the same level of safety and security.²²⁰ Yet, creating confidence and trust among these consumers depends on their relationship with the institution. Offering services designed for fringe bank consumers requires acknowledging the expense, convenience, and cultural preferences of this market segment.²²¹

Agent banking is a cost-effective delivery model for financial institutions.²²² By changing the costs and risks of delivering financial services, distribution channels outside the branch reach large numbers of unserved people. The traditional agency relationship assigns responsibility to the principal for the agent's actions, making this a potentially costly endeavor.

²²⁰ See Ludwig, *supra* note 10.

²²¹ See generally ELISABETH RHYNE, CTR. FOR FIN. INCLUSION, MONEY MANAGEMENT, FINANCIAL INCLUSION, AND BANKING THE UNBANKED 3–5 (2012), <https://swiftinstitute.org/wp-content/uploads/2013/02/Elisabeth-Rhyme-MoneyManagement-Paper.pdf> [<https://perma.cc/6E2A-H4X2>]. As one researcher noted, “From a policy perspective, if bank accounts are opened but not used, their value in terms of broad social or economic objectives is limited.” *Id.* at 4.

²²² Agent banking has resulted in revolutionary inclusion in the financial systems of Brazil, Columbia, Peru, Malaysia, and Kenya as a business model used to provide access to financial services in remote, unbanked areas of developing countries. See Paul M. Leonardi et al., *Multiplex Appropriation in Complex Systems Implementation: The Case of Brazil's Correspondent Banking System*, 40 MGMT. INFO. SERV. Q. 461, 462 (2016) (discussing how Brazil's new banking system has led to financial inclusion); see also Kurt von Mettenheim & Olivier Butzbach, *Alternative Banking: Theory and Evidence from Europe*, 32 BRAZ. J. POL. ECON. 580, 581 (2012) (discussing the success of agent banking in Germany, Spain, Sweden, and Austria).

The proposed model, which is similar to having a satellite bank, is not currently authorized in the U.S. banking structure and requires new law and regulation. What U.S. banking regulation allows are interbank relationships, which permit banks to perform various functions for other banks. Moreover, correspondent banking is defined differently in the United States than in developing countries where the structure is used to promote financial inclusion. In the United States, a correspondent bank, unlike a branch bank, is independent and separate in terms of ownership, financing products, and image. One of the distinguishing features of bank correspondents is that the ordinary bank customer is aware that the banks are separate from one another. The OCC defines “correspondent services” as “hold[ing] deposits for other banks and perform[ing] correspondent services for those banks, such as check clearing.” Off. of the Comptroller of the Currency, Activities Permissible for National Banks and Federal Savings Associations 26 (2017), <https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-activities-permissible-for-nat-banks-fed-savings.pdf> [<https://perma.cc/XTM3-F7GE>]. Among the permissible common interbank functions are receiving deposits on behalf of another bank and disbursement of loan funds. See 12 C.F.R. § 206 (2019) (describing limitations on interbank liabilities); see also *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 114 (1975) (explaining that “in neither law nor banking custom has there developed a clear, fixed definition of the correspondent relationship”).

1. The Law and Economics of Agency

Agency is a beneficial relationship between a principal and an agent that results in an efficient division of labor.²²³ The principal benefits from the effort of the agent; the agent provides the principal with her skill.²²⁴ It is common for the principal to engage an agent even if the task is one that the principal is capable of performing.

One of the significant concerns in agency theory is the misalignment of the incentives that principals and agents have. Principals must always find ways to mitigate the characteristic disincentive that agents have to not perform in the principal's best interests.²²⁵ To encourage the principal's supervision of the agent, law holds the principal responsible for the agent's misdeeds. Unquestionably, the principal has to weigh the expected benefits of the agency relationship against the costs.²²⁶

The presumption in law is that the incentives of agents are aligned with their principals. Principals are held liable for agents' inappropriate conduct or decisions.²²⁷ In economic terms, the relationship raises several "costs" that should be considered.

²²³ See Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U. L. REV. 515, 536–45 (2007) (discussing the agency relationship in light of the preemption doctrine and how the federal preemption doctrine denied state banking regulators the opportunity to police the agents of depository institutions engaging in predatory lending practices).

²²⁴ Agency is (1) a consensual relationship; (2) where one person is a representative of another; (3) the representative has the "power to affect the legal rights and duties of the other person"; and (4) the "person represented has a right to control the actions of the agent." RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).

²²⁵ *Id.* at cmt. c. *Meinhard v. Salmon* is the classic agency case discussing fiduciary duty. See *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928) (finding the defendant liable for a breach of contract in a joint venture agreement when the defendant failed to disclose related transactions to the plaintiff).

²²⁶ Agency is not a costless relationship. The transaction costs a principal must assume are monitoring and bonding costs as well as residual loss. See Alva Curtis, *Delaware and the Market for Corporate Charters: History and Agency*, 15 DEL. J. CORP. L. 885, 916–17 (1990) (discussing Delaware's ability to reduce agency costs in the corporate charters market).

²²⁷ See RESTATEMENT, *supra* note 224, at § 7.02. The law of agency is well summarized by several notable authors. See generally Eric Posner, *Agency Models in Law and Economics* (John M. Olin Law & Econ. Working Paper, No. 92, 2000), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=204872 [<https://perma.cc/V29Z-GLRY>] (describing agency models and agency relationships); Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973) (examining a mathematical model of pareto efficient agency cost allocation).

Principals incur agency costs in order to spread the risk of loss in case of agents' wrongs.²²⁸ Monitoring costs are the costs of observing and possibly controlling the behavior of the agent.²²⁹ Bonding costs are the costs the principal incurs to recoup losses in case the agent acts against the principal in a detrimental manner.²³⁰ Residual loss captures the lost welfare that the principal incurs because of the agent's failure to be productive.²³¹ It protects the principal when the principal cannot fully police the agent's decreased productivity, despite monitoring and bonding costs.²³²

Third parties who deal with agents create significant cause for concern in agency law. Aligning the motivations of principals and agents requires holding the principal responsible for harmful acts of the agent even when the agent acts outside the scope of her duties, as long as there is a causal relationship.²³³ This underlies the rationale that principals can use agents to engage in conduct that would be inappropriate or even unacceptable had the principal herself engaged in the acts.

The inherent conflict of interest between the agent bank's business and the parent bank's raises issues germane for regulatory oversight. Moreover, the obstacles in the prudential regulation of banking services through branchless banking arrangements must be analyzed.

2. Regulatory Oversight and Prudential Supervision of Agent Banking

In places where branching is not cost-efficient due to low deposit enrollment, high transaction costs, and inadequate loan opportunities, agent or branchless banking allows banks to offer traditional products.²³⁴ Agent

²²⁸ See Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y. REV. 265, 278–79 (1998) (discussing the costs that principals impose on agents through an example of risk and loss spreading through a lawyer-client relationship).

²²⁹ See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (describing agency costs as “(1) the monitoring expenditures by the principal, (2) the bonding expenditures of the agent” . . . and “(3) the residual loss.”).

²³⁰ *Id.*

²³¹ *Id.*

²³² See Peterson, *supra* note 223, at 540 (describing residual loss as often the dominant agency cost).

²³³ See discussion *infra* note 277.

²³⁴ This proposal requires explicit statutory authorization and would change the traditional separation of banking and commerce. See Stephen Halpert, *The Separation of Banking and Commerce Reconsidered*, 13 J. CORP. L. 481, 484–90 (1988) (describing three categories of restrictions on bank conduct centered around nonbanking activity). Branchless banking, as it has evolved in the United States, refers to the delivery of financial services outside of bank

banking changes the costs and risks of delivering financial services through distribution channels outside the branch.²³⁵ The typical agent bank hires

branches and without using bank personnel by relying heavily on technology to complete transactions. See Sandra B. McCray, *Constitutional Issues in State Income Taxes: Financial Institutions*, 51 ALA. L. REV. 895, 903 (1987) (discussing how the history of branch banking, as allowing banks to branch across state lines before the Graham-Leech-Bliley Act, eased the restrictions on interstate banking). In emerging countries, branchless banking involves relying upon an agent to assist with the transaction. See Shanthi Elizabeth Senthe, *Transformative Technology in Microfinance: Delivering Hope Electronically?*, 13 PITT. J. TECH. L. & POL'Y. 1, 17 (2012) (describing the role of microfinance institutions delivering products, such as mobile banking, in an increasingly technological world). Professor John Caskey recommends a different, but similar approach for reaching the unbanked. See JOHN P. CASKEY, BRINGING UNBANKED HOUSEHOLDS INTO THE BANKING SYSTEM 5 (2002), <https://www.brookings.edu/wp-content/uploads/2016/06/caskey.pdf> [<https://perma.cc/89DW-5TUH>]. He proposes having banks offer check-cashing services at highly competitive rates in specialized bank branches or “outlets.” *Id.* Caskey posits that this would create new sources of revenue, adding to the branches’ profitability. *Id.* Additional services would include wire transfers and remittances and in-person payment services for utility and other household bills. *Id.* The other unique feature of the outlets would be their placement, which should be in locations that are convenient for LMI households. *Id.*

²³⁵ Correspondent banking, a type of agent banking, is a very popular and successful business model that provides access to financial services in remote, unbanked areas of developing countries. See Leonardi, *supra* note 222, at 461 (describing the rise of a new banking system aimed at overcoming financial exclusion through providing access to a country’s formal financial system). The proposed model, which is similar to having a satellite bank, is not currently authorized in the U.S. banking structure and requires new laws and regulation. What U.S. banking regulation allows are interbank relationships, which permit banks to perform various functions for other banks. Moreover, correspondent banking is defined differently in the United States than in developing countries where the structure is used to promote financial inclusion. In the United States, a correspondent bank, unlike a branch bank, is independent and separate in terms of ownership, financing products and image. One of the distinguishing features of bank correspondents is that the ordinary bank customer is aware that the banks are separate from one another.

Fintech, Financial services via technology, is a disrupter that is leading towards wholesale digital transformation of the banking industry. As noted earlier, the Federal Reserve’s efficacy as a link between payments and the transmission of money is critical. In August 2020, the Federal Reserve announced the FedNow Service, which will operationalize in 2023 or 2024. *FedNow Service*, BD. OF GOVERNORS OF THE FED. RES. SYS., https://www.federalreserve.gov/paymentsystems/fednow_about.htm [<https://perma.cc/HTF5-ZKY2>] (last updated Aug. 6, 2020). The liquidity tool will support an instant payment service providing real-time payment to consumers. To the extent that it allows LMI consumers to avoid high-interest loans and expensive check cashing services, it will both provide access to and decrease the costs of participating in the formal banking economy. Jeanna Smialek, *The Fed Moves Closer to a New Way to Get People Their Money Faster*, N.Y. TIMES (Aug. 6, 2020), <https://www.nytimes.com/2020/08/06/business/the-fed-moves-closer-to-a-new-way-to-get-people-their-money-faster.html> [<https://perma.cc/V2MZ-7WP3>].

nonfinancial commercial establishments as agents.²³⁶ These entities provide financial services on the bank's behalf, increasing the geographical dispersion of banking services.²³⁷ Agent banking systems are more sustainable than branch banking because mobile technology and the existing network of local agent bank retailers control establishment and operation costs.²³⁸

Agent banking systems widen the parent bank's distribution channel for products and services through the contractual relationship between the parent bank and the agent bank.²³⁹ The contract determines the scope of services, i.e., accepting deposits and making loans, fees paid and risk-sharing. Preferably, agent banking combines the services of banks

²³⁶ This proposal raises the common conflict of the powers and duties of banks versus nonbanks. A bank is commonly defined as an institution that takes deposits and makes commercial loans. *See, e.g.*, Bank Holding Company Act of 1956, 12 U.S.C. § 1841(c) (1982) (defining bank holding companies and stipulating rules for expansion and divestment). Nonbanks are restricted to offer only one of these services. *See generally* Carl Felsenfeld, *Nonbank Banks—An Issue in Need of a Policy*, 41 BUS. LAW. 99, 100 (1985) (discussing deregulating the activities of bank holding companies). Although the agent bank will accept deposits, it will be a subsidiary of a bank and regulated by the Federal Reserve under the Bank Holding Company Act.

²³⁷ *See id.* (discussing the implications of forming a “nonbank bank” in this way).

²³⁸ *See* Dzikamai Shoko Bizah, Linda Gumbo & Rabson Magweva, *Agent Banking as a Driver of Financial Inclusion in Zimbabwe: A Review*, 5 INT'L J. EDUC. & RES. 89, 92–94 (2017) (concluding that agent banking reduces most of the transactional costs of banking). Another author identifies and describes four types of agent banking:

1. POS-enabled bank agent – This is an agent managed by a bank that uses a payment card to identify customers.
2. Mobile phone-enabled agent – This is an agent managed by a bank that uses a cell phone to identify customers.
3. Mobile wallet – This is an agent that is often managed by a telecom, uses a cell phone to identify customers, and provides store-of-value accounts called mobile wallets that are backed by bank deposits. Customers can use mobile wallets to send, receive, and store electronic monetary value. For this analysis, we consider them a store of value account that provides a useful comparison for a savings account directly provided by a financial institution.
4. Bank-provided account linked to a mobile wallet – This is a bank account that is linked to a mobile wallet. The bank does not manage the agent and pays a fee to the telecom for deposits and withdrawals.

CLAIRE VENIARD, HOW AGENT BANKING CHANGES THE ECONOMICS OF SMALL ACCOUNTS 1–2 (2010), <https://docs.gatesfoundation.org/Documents/agent-banking.pdf> [<https://perma.cc/HW8W-C3FZ>].

²³⁹ *See* Henry Thomas Mwangi Maina & Willy Mwangi Muturi, *Factors Influencing the Uptake of Agency Banking Services by Customers in Commercial Bank in Kenya: A Case of Kenya Commercial Bank*, 2 STRATEGIC J. BUS. CHANGE & MGMT. 179, 181 (2014) (describing agency banking's potential to increase financial services provided to lower income individuals who are not sufficiently reached by traditional bank branch networks).

and check cashers. In addition to cashing checks and processing bill payments, agent banks should have transactional operations, accepting deposits for checking and savings accounts.²⁴⁰ Banks can expand their profits as consumers become aware of the banks' available products for credit, saving, and insurance.²⁴¹

An agent banking system, while most cost-effective for transactional accounts with low balance and frequent transactions, offers advantages for both the fringe bank consumer and the financial institution. For the fringe bank consumer, location alone increases inclusivity.²⁴² The convenience of less travel time to access banking services is important. Moreover, banking services in retail locations have flexible hours and are in a familiar, non-threatening environment.²⁴³ Agent banking systems dramatically diminish rent, administration costs, and labor costs. In addition to the reduced infrastructure and customer costs, the financial institution incurs transaction costs only when a transaction occurs.²⁴⁴ Agent banks can also expect an increase in revenue and the high likelihood of a new customer segment.²⁴⁵ Although an agent banking system is an optimal way to develop scale in financial inclusion, it has its disadvantages. Repeated incidences with the logistics of poor service could discourage consumer use. If locations are not

²⁴⁰ Agent banking systems reach optimal profitability when consumers use mobile based agents and mobile wallets. See VENIARD, *supra* note 238, at 3 (discussing the cost-effectiveness of transactional accounts for agent banking systems).

²⁴¹ *Id.*

²⁴² See Anjali Kumar et al., *Assessing Financial Access in Brazil* 24–26 (World Bank Working Paper No. 50, 2005), <http://siteresources.worldbank.org/EXTINCLUSIVEFIN/SYS/Resources/AccessToFinancialServicesBrazil.pdf> [<https://perma.cc/2S35-MEAN>].

²⁴³ See SAI KUMAR JAYANTY, *AGENCY BANKING: NEW FRONTIERS IN FINANCIAL INCLUSION* 3 (2012) (discussing how agency banking has reduced costs even as it reaches new customers); CAITLIN SANFORD, *DO AGENTS IMPROVE FINANCIAL INCLUSION? EVIDENCE FROM A NATIONAL SURVEY IN BRAZIL* 15 (2013) (arguing that despite their convenience and accessibility, agent bank services are not of a good quality).

²⁴⁴ Transaction costs make banking operations in underutilized locations extremely expensive given the fixed costs of operating a branch. On the other hand, given that the agent bank's operating costs are fixed already, the agent bank is incentivized to operate as a financial services provider at full capacity because each transaction earns a commission. See VENIARD, *supra* note 238, at 3 (finding that total costs per deposit transaction are significantly higher if the delivery channel is a branch instead of an agent bank).

²⁴⁵ While arguably agent banks can cross-sell financial products, a more effective strategy may require incurring additional marketing and sales costs. See Anjali Kumar et al., *Expanding Bank Outreach Through Retail Partnerships: Correspondent Banking in Brazil* 3–4 (World Bank, Working Paper No. 85, 2006), <http://documents.worldbank.org/curated/en/912991468016248173/pdf/363980Retail0p101OFFICIAL0USE0ONLY1.pdf> [<https://perma.cc/L7AN-TH2C>] (showing how formal, regulated financial institutions have partnered with commercial entities to bring financial services to underserved communities and develop new sources of revenue).

secure or problems recur with network connectivity or equipment malfunctions, customers may also become dissatisfied.²⁴⁶ The failure to maintain liquidity or to meet the cash needs of customers could result in discontinued use.²⁴⁷ The increased regulatory requirements and more complex procedures and product offerings could increase the costs of operating an agent banking system.²⁴⁸ Agent banks hire their own employees. While financial institutions often adopt a corporate identity and culture to influence the customer experience, financial institutions cannot directly control the behavior of the agent bank's employees. Thus, the behavior and conduct of the agent bank and its employees in providing the services could send a message of disinterest and dissuade customers from using agent banks.

3. Agent banking and the payment system

Payment systems ensure the circulation of money through a coordination of policies and procedures that facilitate the clearing and settlement of funds. The payments service market is composed of various arrangements that coordinate the production, processing and pricing of payment instruments, services and delivery.²⁴⁹ The payment infrastructure connects payment service providers and users through information service operators and technology providers.²⁵⁰

Agent banking needs a robust competitive payment system in order to operate. Interoperability among payment systems means a system or product is compatible with other systems or products.²⁵¹ Ideally, interoperability allows for seamless payment transfers regardless of country, bank, currency, or regulations.

²⁴⁶ See Fred Gichana Atandi, *Challenges of Agent Banking Experiences in Kenya*, 3 INT'L. J. ACAD. RES. BUS. & SOC. SCI. 397, 399 (2013) (describing the potential barriers to agent banking implementation).

²⁴⁷ Maina, *supra* note 239, at 181.

²⁴⁸ See VENIARD, *supra* note 238, at 4.

²⁴⁹ For a discussion of the role of central bank money in payment systems, see generally Disyatat, *supra* note 143.

²⁵⁰ See generally *id.*

²⁵¹ In the United States, the automated clearing house system (ACH) has developed because of the involvement of the Federal Reserve. The Federal Reserve Bank system has facilitated interoperability through effective regulation, an efficient, operational infrastructure, and using the ACH for government benefits and tax payments. The Electronic Payments Network also runs a part of the ACH Network. See Steve Mott, *Can ACH and Image Convergence Succeed?*, BAI BANKING STRATEGIES, Sept.–Oct. 2006, at 1, 2; *Processing Services*, ELEC. PAYMENTS NETWORK, <https://www.epaynetwork.com/cms/services/processing/001459.php> (last accessed June 5, 2020); *Fed. Res. Fin. Servs.*, FED. ACH OPERATIONS AND PROCESSING, <https://www.frbservices.org/Retail/OperationsProcess.htm> [<https://perma.cc/CT5Y-TMVE>].

The cooperative development of processes and technologies by banks, networks, processors, and other service providers has the advantage of being both cost-efficient and enhancing risk management.²⁵² Interoperability can also be achieved when mandated by regulations.²⁵³ By designing a simple and relatively inexpensive system and supporting state government use of the ACH system, the Federal Reserve made access to the national payment system less demanding. Using the dynamic retail payment market will require a balance between cooperation and competition. The mechanism for the clearing and settlement of relatively low-value payments means that communication service operators and other nonfinancial entities provide the services. As shown below, the benefit of a deeper, more diversified financial system is long-term financial stability making the potential costs of financial inclusion compensable.

B. An Agent Banking Model for the U.S.

A financial access agenda must balance the innovation and experimentation needed without compromising the safety and soundness of the banking system. The 2017 FDIC National Survey included information on the use of mobile banking by the underbanked and showed an increasing familiarity of mobile banking use for basic financial transactions.²⁵⁴ Technology can permit banks to manage the differentiated customer model that fringe bank customers need profitably and safely. Agent banking allows banking beyond branches by providing access to banking through electronic transactions.²⁵⁵ Based on the success in emerging economies, a modified

²⁵² See Amelia H. Boss, *Convergence in Electronic Banking: Technological Convergence, Systems Convergence, Legal Convergence*, 2 DREXEL L. REV. 63, 91 (2009) (discussing the regulatory gaps in convergence and interoperability of payment platforms).

²⁵³ Interoperability in payment systems is achieved when: 1) banks join a simple scheme, agreeing to be bound by rules set by that scheme, 2) network interoperability, connecting networks through a negotiated payment scheme and exchange agreement- often used for cross-border or cross-regional payments acceptance, 3) parallel system interoperability, allowing merchants or agents accepting payments from consumers to participate in multiple schemes. See Carol Coye Benson & Scott Loftesness, *Interoperability in Electronic Payments: Lessons and Opportunities*, CONSULTATIVE GRP. TO ASSIST THE POOR (May 2013), <https://www.cgap.org/research/publication/interoperability-electronic-payments-lessons-and-opportunities> [<https://perma.cc/YP8D-EAKF>] (describing three conditions for achieving interoperability in payment systems).

²⁵⁴ More than two in five unbanked households already use mobile banking for basic financial transactions. 2017 FDIC SURVEY, *supra* note 2, at 14.

²⁵⁵ See Ignacio Mas, *Shifting Branchless Banking Regulation from Enabling to Fostering Competition*, 30 BANK. & FIN. L. REV. 179, 183–84 (2015) (discussing the need to curtail the barriers to entry while protecting the integrity and stability of branchless banking).

version of branchless banking might work in the United States. Relying on mobile connections, banking agents connect to financial institutions in real-time, allowing banks to deliver transaction services through an intermediary more efficiently than delivering them directly. Banks can create wide-reaching branchless channels that use cards and point-of-sale (POS) devices.²⁵⁶ This solution addresses the high costs and lack of proximity that exclude so many from access to the formal banking sector.²⁵⁷

The most significant feature of this model is that the financial products should be transformational. The mobile financial products offered should be based on research that integrates innovation with features that the unbanked need to access the banking economy. Products that are made specifically for fringe bank consumers consider their need for cash, no float requirements, and small dollar loans. These mobile banking products should

This discussion distinguishes agent and branchless banking, which provides financial services digitally from Fintech companies. While both use electronic transactions, branchless banking is a platform offered by banks that allows customers to access cash or accounts through mobile phones using Internet connectivity. See ANNABEL SCHIFF & MIKE MCCAFFREY, REDESIGNING DIGITAL FINANCE FOR BIG DATA 5–6 (2017), <https://www.ssrn.com/abstract=2967122> [<https://perma.cc/X4ZG-CRJY>]. It helps the unbanked by providing electronic access to a bank account, and allows customers to contract for new services, such as loans, insurance, or certificates of deposit. Fintech companies are technology companies that provide access to the payment system through banks. *Id.* It refers to using a mobile device to access information from or send information to an existing bank account. *Id.* It is beneficial to banked customers, but not to the unbanked.

²⁵⁶ Several central banks have adopted this model. For example, the Reserve Bank of India (RBI) uses business facilitators and business correspondents. Agents under this model function similar to the way correspondent agents function under the model used by the Central Bank of Brazil. Correspondent agents provide a wide array of services, including disbursing small-value credit, collecting loan payments, performing small-value remittances and selling credit. Those regulations also authorize transactional agents, who engage in bill payments, withdrawals, and transfers. See generally, *Guidelines for Engaging of Business Correspondents*, RES. BANK OF INDIA, https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=2234#A3 [<https://perma.cc/WRR2-3KSU>] (last accessed May 19, 2020).

²⁵⁷ Agent or “branchless banking” is 19% cheaper than traditional banking because of the lower overhead expenditures. CLAUDIA MCKAY & MARK PICKENS, BRANCHLESS BANKING 2010: WHO’S SERVED? AT WHAT PRICE? WHAT’S NEXT? 5 (2010), <https://www.cgap.org/sites/default/files/researches/documents/CGAP-Focus-Note-Branchless-Banking-2010-Who-Is-Served-At-What-Price-What-Is-Next-Sep-2010.pdf> [<https://perma.cc/DQN8-94XS>]. In a recent study, the Federal Reserve Board studied consumers’ use of mobile technology to access financial services and make financial decisions. See BD. OF GOVERNORS OF THE FED. RES. SYS., CONSUMERS AND MOBILE FINANCIAL SERVICES 1 (2016), <https://www.federalreserve.gov/econres/data/mobile-devices/files/consumers-and-mobile-financial-services-report-201603.pdf> [<https://perma.cc/P3P9-J3VT>] (finding that the use of mobile payment activities was lower than the use of mobile banking).

be distinguished from those mobile banking products developed and marketed for the bank's general population.²⁵⁸

The similarities in the operations of banks and agent bank retailers speak to the needs of fringe bank consumers. First, agent bank retailers will offer identical services as check cashers.²⁵⁹ Familiarity and the absence of stigma are among the reasons that many underserved consumers use check cashing outlets. With numerous agent bank retailers presumably available throughout a community, the consumer chooses the preferred retailer, thereby encouraging participation and frequent use. The fact that many retail establishments already cash checks makes this idea even more cogent.

Second, consumers will experience greater efficiency in banking services. Agent bank retailers will become transaction centers, handling the routine transactions usually conducted at a branch, e.g., deposits, withdrawals, balance inquiries, transfers, and account registration. This change gives consumers access to a wider selection of services than check cashers can legally provide. Consumers will benefit from lower transaction costs with the accumulated costs of check cashing and money order purchases removed.²⁶⁰ They are also encouraged to save. After depositing a paycheck, bill payments can be debited from an account with a balance remaining to withdraw later. Depositing funds in a bank reduces the risk of theft for consumers.

Prudential regulation of banking makes using a "bank-centric" model optimal. A bank develops its own mobile-banking platform to assess the payment system that its agents use.²⁶¹ The role that banks play in the payment system provides a strategic advantage and also generates revenue. Using the

²⁵⁸ See Ahmed Dermish et al., *Branchless and Mobile Banking Solutions for the Poor: A Survey of the Literature*, 6 INNOVATIONS 81, 84 (2011) (discussing the feasibility and utility of branchless and mobile banking); see also DAVID PORTEOUS, JUST HOW TRANSFORMATIONAL IS M-BANKING? 9–10 (2007), <http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-just-how-transformational-is-m-banking-feb-2007.pdf> [<https://perma.cc/GNX2-4W2U>] (discussing how mobile banking has altered the banking landscape, especially with regard to accessing basic banking accounts in South Africa).

²⁵⁹ Agent bank retailers will offer this service as a convenience, but not necessarily for a lower price. See Rubin, *supra* note 28, at 232 (positing that the proliferation of check cashing outlets in low-income neighborhood makes the pricing competitive).

²⁶⁰ *Id.*

²⁶¹ *Id.* at 220–21. Due to the lack of regulation and supervision of nonfinancial institutions, a branchless banking model based on nonfinancial institutions providing financial services is not recommended. Non-financial institutions, such as fintech companies, are subject to OCC regulations, but as discussed above, *supra* note 255, those technology platforms are not a solution to the problem of the unbanked because they require customers to have bank accounts. One commentator prefers "banking beyond bank branches" because of the specialized banking channels that develop. See Claire Alexandre, Ignacio Mas & Daniel Radcliffe, *Regulating New Banking Models to Bring Financial Services to All*, 54 CHALLENGE 116, 123 (2011) (arguing that existing branching restrictions and branch regulations should be modified).

bank's branding, agent bank retailers who are geographically dispersed reach a wider customer base. The agent bank retailers pay the bank to offer transaction services making these services more cost-efficient for both the customer and the bank.²⁶² The lack of dependence on a telecommunications company means more control and more profit for the bank. It also assures intuitional solvency and fiscal stability because of the applicable banking regulations.²⁶³

Regulatory classifications will determine the functions and services. Agent banks can provide essential services, including check cashing services, bill payments, withdrawals, and transfers.²⁶⁴ They could also identify borrowers, collect and submit account and loan applications, therefore verifying and doing preliminarily process data.²⁶⁵

The account structure will limit the principal bank's liability. The agent bank retailers' deposit-taking is designed so that it is merely an inter-account transfer, which does not increase the liabilities of the banking system. To limit the bank's credit exposure, the agent bank should be required to pre-purchase electronic value from the principal bank.²⁶⁶ A customer's cash deposit will result in an immediate transfer of an equivalent electronic value from the store's account to the customers' account. Provided that the bank authorizes the transaction in real time, no financial risks arise from the store's

²⁶² The integration of “[t]he value of data integrated to a live registration, underwriting and onboarding process is a prime example of how solution providers can bring improved efficiency and KYC elements to financial institutions while enhancing the service delivery for their merchants and reselling partners.” Richard McShirley, *Innovation: Bank Centric Payments*, BANKNEWS (Jan. 26, 2020), <https://www.banknews.com/blog/innovation-bank-centric-payments/> [<https://perma.cc/G8P9-KTP8>].

²⁶³ A bank-centric model is characterized as one where the “the bank leads the chain.” See Sente, *supra* note 234, at 19. In addition to the bank-led model of mobile banking, there are several other ways to implement agent banking. These include: 1) mobile network operators (MNOs), i.e., the teleco-led model, a partnership with telecommunications carriers and technological companies; 2) microfinance institutions (MFIs) which can serve as financial institutions; 3) MFIs acting as agents for commercial financial institutions; and 4) the “consortium model,” comprised of private and public sector members, such as MFIs, technology, and financial groups. *Id.* at 17–21.

²⁶⁴ For example, an agent bank would perform a “cash-in cash-out function” when a customer cashes a check. The agent bank debits its account at its bank and credits the customer's account at the agent bank. Providing “cash in/cash out” service is a ‘deposit-taking’ activity requiring regulatory compliance. 12 U.S.C. 1813(l) (2018).

²⁶⁵ The Bank Secrecy Act (BSA) imposes customer due diligence on financial institutions as a way of combating illicit financial activity and traditional financial crimes, including money laundering, fraud, and tax evasion. The corresponding “Know Your Customer” (KYC) regulation requires banks verify customers who open new accounts. *See* 31 C.F.R. 1010.100(e) (2019). While agent bank retailers could assist with this function, arguably there should be less stringent KYC requirements for low-dollar transactions.

²⁶⁶ The bank is able to limit its liability because of the pre-paid account but only if the transactions are authorized in real time by the bank.

handling of the deposit.²⁶⁷ By exchanging the customer's cash for an equivalent deposit into the prepaid account, the retailer never holds any financial assets that belong to either the customer or the bank. What appears to be the taking of a deposit is merely a cash swap.²⁶⁸ Using mobile technology, customers are able to immediately see their accounts credited securely, thereby reducing any risk. Banks can serve those previously underserved due to the small or zero profit margin and develop a viable market segment.²⁶⁹

Small-dollar bank accounts established through an agent bank retailer raise issues of how to protect them. The funds are not bank deposits nor stored in the customer's name. Regulations should require fund custodians to store an equivalent amount in a bank account or pooled trust accounts. Investments should be in low-risk liquid assets and restrict the use of the electronically stored-value sums.²⁷⁰

The branchless banking infrastructure is critical in order to mitigate operational and technological risks. To the extent that branchless banking uses mobile banking platforms, it is subject to telecommunications and financial regulation.²⁷¹ Banking regulations have explicit rules regarding reporting, ownership,²⁷² and deposit pooling limitations²⁷³ that agent bank retailers will need to comply with or modify. Specifically, agent banking regulations need to define the delivery channels and provide for license and registration

²⁶⁷ See Claire Alexandre et al., *Regulating New Banking Models to Bring Financial Services to All*, 54 CHALLENGE 116, 132 (2011).

²⁶⁸ As the authors explain:

Viewed in this light, the store is not acting as an agent for the bank in the legal/economic sense: the store is its own principal. The store acts as a cash merchant, offering cash in/out services because it sees a revenue-generating opportunity from leveraging its own bank account. The store is more of a value-added reseller of the bank's service – a super-user that uses its account to take the other side of a customer's transaction (i.e. either cash for e-money, or vice versa).

Id. at 125.

²⁶⁹ See Alberto Chaia et al., *A New Idea in Banking for the Poor*, MCKINSEY & CO. (Nov. 10, 2010), <https://www.mckinsey.com/industries/financial-services/our-insights/a-new-idea-in-banking-for-the-poor> [<https://perma.cc/4K8Q-C2PA>] (proposing that, “[b]y teaming up with retail outlets in low-income, often hard-to-reach areas, financial institutions can create value both for themselves and their new customers”).

²⁷⁰ See generally KATE LAUER, DENISE DIAS & MICHAEL TARAZI, *BANK AGENTS: RISK MANAGEMENT, MITIGATION, AND SUPERVISION* (2011), <http://www.cgap.org/sites/default/files/researches/documents/Focus-Note-Bank-Agents-Risk-Management-Mitigation-andSupervision-Dec-2011.pdf> [<https://perma.cc/GE8A-VBJU>] (discussing challenges of regulating agent bank investments.)

²⁷¹ Senthe, *supra* note 234, at 12–20 (discussing generally how microfinance banking requires an interaction between technology and banking regulations).

²⁷² 12 C.F.R. § 330.6-339.13 (2018).

²⁷³ 12 C.F.R. § 32.3 (2018).

procedures.²⁷⁴ The deposit taking activity needs capital adequacy requirements which will set minimum capital thresholds.²⁷⁵ Regulations could dictate different levels of licensing and registration based on the nature of the deposit-taking entity, account balance limits or channels through which deposits are taken.

Oversight policies for a safe and efficient payments system balance the trade-offs between financial stability, efficiency, and soundness.²⁷⁶ The stability and integrity of the financial system requires regulators to address the prudential concerns of consumer protection; the security and efficiency of the payments system; as well as data security, privacy, and accessibility. Regulations will be needed to determine agent suitability and licensing. Those regulations should discuss compliance and risk management functions, including liquidity management, as well as procedures and how agents will be staffed, monitored and renewed.²⁷⁷

Using agent bank retailers may bring new consumer protection risks. Regulation in this area must meet the difficult goal of promoting innovation while simultaneously protecting consumer interests. Creation of effective new products requires customers to perceive them as trustworthy and fair. The risk to consumers arising from loss of payment instruments, fraudulent transactions, and entity theft raise common supervisory concerns that may need to be addressed.²⁷⁸ Although a number of nonfinancial providers are involved in agent banking, e.g. mobile phone companies and agent retailers,

²⁷⁴ Although most agent banking is done through mobile phones or retail agents, the FTC, which regulates unfair trade practices, does not have regulatory authority over mobile banking. 15 U.S.C. § 45(a)(2) (2018) (providing that the FTC's jurisdiction does not extend to "banks" or "savings and loans institutions"). For additional background on the new opportunities in mobile banking created by information and communications technology, see generally Michael Klein & Colin Mayer, *Mobile Banking and Financial Inclusion: The Regulatory Lessons* (World Bank Policy Research Working Paper No. 5664, 2011), <http://documents1.worldbank.org/curated/en/516511468161352996/pdf/WPS5664.pdf> [<https://perma.cc/JK5T-5CMZ>].

²⁷⁵ Implementing the proposals recommended in this Article requires changing the structure of insured deposit accounts. The FDIC, as the regulator of depository institutions, arguably would have appropriate regulations for the supervision of these entities.

²⁷⁶ See Malaguti, *supra* note 29, at 1–2 (asking, "how can regulators balance the creation of an inclusive payments system with maintaining its stability, integrity, and safety?").

²⁷⁷ Banking regulators need access to all data on the agent. Agent banks will be subject to reporting, inspection, and examination to assess and monitor. Regulators should require banks to seek approval before any major operational or infrastructure change. Onsite inspection of a bank is planned based on the materiality of operations or the risk assessment conducted through offsite monitoring. See LAUER ET AL., *supra* note 270, at 1–12.

²⁷⁸ DANIEL LOZANO ET AL., A NEW AGENT MODEL FOR BRANCHLESS BANKING IN COLOMBIA 9–11 (2010) (discussing traditional banks and branchless banking).

those providers would be subject to existing transparency and disclosure requirements for consumer financial transactions.²⁷⁹

Finally, identifying and keeping track of the specific tasks that agent bank retailers perform is also critical for determining financial inclusion. Specifically, significant financial measures include the number of agent bank retailers, the percentage of the principal bank's business and the activities (as measured by principal's assets or revenues or profits), the percentage of the loan portfolio handled by agent bank retailers, and the number and aggregate size of all transactions handled by the agent bank retailers.

In using the branchless banking model, agent banking can impact financial inclusion positively for both consumers and banks. Access to affordable financial services benefits fringe bank consumers, who have a more secure environment to manage their financial lives. The benefits of financial inclusion to the economy as a whole raises the issue of the central bank's responsibility to ensure access to the formal banking sector.

C. Federal Reserve Policy and Financial Inclusion

Central banks have the dual objectives of promoting and maintaining a safe and efficient payment system and providing access to it. Central banking arguably creates a social contract between the banking system, regulators, and the government. As discussed above, the involvement of central banks in the global economic crisis reflects a "seamless" banking system and is fundamental to a well-functioning financial system.²⁸⁰ Central bank intervention is required to promote financial stability, which is enhanced when every citizen has access to the payment system.

²⁷⁹ CFPB has jurisdiction over "service providers" and "covered persons." See Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 344–47 (2013). Covered persons are defined as "any person that engages in offering or providing a consumer financial product or service and any affiliate of a [covered person] if such affiliate acts as a service provider to such person." 12 U.S.C. § 5481(6) (2018). Service provider "means any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service . . ." *Id.* at § 5481(26). Consumer transactions, which would include agent banking, fall within the defined scope of "consumer financial products or services," as long as the service "is offered or provided for use by consumers primarily for personal, family, or household purposes" or certain ancillary services provided in connection with the offering or provision of a consumer financial product." See Levitin, *supra* note 279, at 345. Therefore, at a minimum, agent bank retailers must comply with CFPB regulations. Thus, consumers engaging with agent bank retailers will have consumer protection at the federal level.

²⁸⁰ See discussion, *supra* Subsection III.A.3.

The distributive effects of financial sector regulation regarding bank access needs greater clarity and focus. Access to financial services, the safe transfer of funds, and monetary exchange all occur through payment and settlement systems. Undoubtedly, the Federal Reserve's role in maintaining economic stability is a critical one; equally important is the Federal Reserve's role in regulating the financial sector to alleviate inequality in the larger economy. The failure to develop an inclusive financial infrastructure increases risk; stymies economic development; and has negative consequences on the fiscal competitiveness of individuals, communities, and small businesses.

1. Tax Incentives for Inclusionary Banking

An inclusive economy requires that every citizen has access to financial products and services that are that useful and cost-effective. The payments system is the gateway to financial inclusion. As discussed above, the Federal Reserve has a strong interest in maintaining a safe and efficient payment system that will help support economic activity and promote the smooth implementation of monetary policy.²⁸¹ The fundamentals of financial inclusion, fair access to the market, a level playing field, support for innovation, and some level of interoperability are the same for the payment system. The question becomes how to implement these parallel objectives.

Tax legislation is commonly used to achieve social or economic goals. A fundamental premise of tax policy is the provision of public goods and services. A tax incentive is way of instituting a policy without a direct governmental expenditure, sometimes described as a "small economic footprint" that does not disrupt market forces.²⁸²

The new delivery channels for financial products and services as proposed in this Article require leveraging developments in mobile technology. Financial institutions that offer transaction accounts to fringe bank consumers may need tax incentives or credits to defray the costs of providing traditional banking services.²⁸³

²⁸¹ See *infra* Subsection III.A.3.

²⁸² Ruth Mason, *Federalism and the Taxing Power*, 99 CAL. L. REV. 975, 977 (2011) (defining tax subsidies as "tax laws that offer special tax deductions, credits, and other tax benefits designed to accomplish public policy goals"). Although often lauded as a way to achieve social equity, one commentator questions whether tax incentives are reviewed for effectiveness. See generally Richard Krever, *Analysing Implicit Tax Expenditures*, 35 MELBOURNE U. L. REV. 427 (2011) (positing that indirect tax subsidies and incentives should be evaluated as rigorously as explicit tax spending for their benefits).

²⁸³ No federal law requires banks to offer basic bank accounts. The Dodd-Frank Act authorized Treasury to implement a program of grants to "enable low- and moderate-income individuals to establish one or more accounts in a federally insured depository institution."

Existing law allows national banks to make investments that are primarily designed to promote the public welfare and that primarily benefit LMI individuals and LMI areas.²⁸⁴ This incentive alone could encourage bank agent retailers and thereby further financial inclusion.

However, allowing a financial inclusion tax incentive for banks that provide LMI bank accounts implicitly encourages banks to act in the public interest. It is an additional way of recognizing that affordable access to the payment system is a public good. A financial inclusion tax incentive would target LMI accounts while relying on the banks' voluntary cooperation to implement this regulatory goal.²⁸⁵

A financial inclusion tax incentive is a more feasible alternative than the direct spending required for postal banking. First, postal banking requires the government to create a separate, costly financial services infrastructure to handle LMI bank accounts. Second, postal banking necessitates the postal service developing competence and expertise in financial services. Conversely, a financial inclusion tax incentive absorbs some of the costs of providing LMI bank accounts; it also offers a viable option to banks willing to partner with the government to provide a government-sponsored banking service.

2. Annual Reporting

The objective of financial inclusion policy is to integrate the unbanked into the formal financial economy. Formal financial services are costly for both banks and the underserved. The small volume of cash that fringe bank customers circulate makes providing formal banking services

12 U.S.C. § 5623 (2018). The FDIC initiated a pilot program, FDIC Model Safe Accounts, that encouraged banks to offer low fee transactional accounts that disallowed checks and overdraft transactions. Although the economic feasibility for banks of offering the accounts was not reported, some of the participating banks reported the marginal costs of the accounts was low. FED. DEPOSIT INS. CORP., FDIC MODEL SAFE ACCOUNTS PILOT: FINAL REPORT 7 (2012), <http://www.fdic.gov/consumers/template/SafeAccountsFinalReport.pdf> [https://perma.cc/68CA-YQ5Y].

²⁸⁴ The National Bank Act gives banks this investment authority and also authorizes investments in areas targeted by a government entity for redevelopment. *See* 12 U.S.C. § 24 (2018) (“Eleventh. To make investments directly or indirectly. . . .”); 12 C.F.R. § 24 (2018) (implementing the regulation). Banks are also eligible for a “qualified investment” tax credit as defined under the CRA. *See* 12 C.F.R. § 25.23 (2018).

²⁸⁵ Eligibility for the tax incentive should be based on specified guidelines. For example, Massachusetts state law requires state-chartered banks to provide certain consumers with no cost checking and savings accounts that meet definitive guidelines regarding available transactions and services. *See* Mass. Gen. Laws ch.167D, § 2 (2019).

inefficient for most large banks. Fringe banking is convenient, but expensive with no savings or credit history component.

Financial inclusion is measured biennially in the United States, yet, for fringe bank consumers, a need remains to increase affordable, secure access to payment services. The specific financial inclusion challenge faced in the U.S. is providing competitive, low-cost bank accounts for LMI consumers who are unable to maintain minimum account balances rather than access to non-competitive, higher priced payment services.

As argued above, failure to correct financial exclusion is a negative statement about the value of economic inclusion in this country.²⁸⁶ It also forestalls the economic spillover when cash-based transactions are counted in the economy. The importance of financial inclusion for economic development requires crafting a national strategy to address specific challenges and achieve specific goals. Although this national priority is commonplace in developing countries, and usually is implemented by their central banks, the United States has not made a serious commitment to financial inclusion

Banks should report and be specifically graded on financial inclusion as a part of the yearly CRA assessment. Currently, the lack of data makes it difficult to accurately assess what banks are doing to bring fringe bank consumers in their communities into the formal banking sector. Among the factors relevant to the CRA service test is the availability and effectiveness of alternative systems for delivering retail banking services in LMI geographies and to LMI individuals.²⁸⁷ While banks receive CRA points for providing low-cost checking and savings accounts, no data on the number of accounts offered and the income of the customers is required. In addition, CRA exams should assess whether the accounts are affordable in terms of overdraft protection and high fees that make the accounts too expensive for LMI consumers. This focused reporting allows for a more nuanced understanding of how banks are performing in the LMI markets.

Financial inclusion requires a competitive banking system, with institutions designed to serve the particular needs of LMI consumers. These proposals encourage the Federal Reserve, as the nation's central bank, to take affirmative steps to embrace its mandate and ensure equitable, sustainable, access to the payment system for all Americans.

²⁸⁶ See *supra* Section II.A.

²⁸⁷ See 12 C.F.R. § 345.24(d) (2019) (providing performance criteria for retail banking services).

CONCLUSION

Two fundamental market failures—bank concertation and the low quality of the fringe banking industry—apply distinctively to financial exclusion. Balancing costs with access is the conundrum that banks face. Yet, a stable economy requires a competitive banking system, with institutions deigned to serve the particular needs of LMI persons. Additionally, allowing the informal banking sector to monopolize providing financial services to LMI consumers is a choice that furthers income and economic inequality. Instead, the United States should consider branchless banking—the regulatory approach adopted in several developing countries. The change would contribute to addressing the non-competitiveness and market failures of the fringe banking industry.

The banking regulatory framework can remove structural barriers that constrain access by investing in financial infrastructure where fringe bank consumers live and work. Using mobile payment platforms and existing retail stores agents, a new delivery channel can provide access with lower transaction costs for both banks and consumers.

Policies that enable banks to contract with nonbank retail agents to provide financial services have proven highly successful in advancing financial inclusion where bank branches are not economically viable. With technology reducing the costs and risks of these financial transactions, banks and retail businesses, acting as bank agents, can enter into a viable, cost-effective and useful strategic partnership.

Branchless banking presents significant regulatory and supervisory challenges. Regulation in this area must meet the difficult goal of promoting innovation while simultaneously protecting consumer interests. The proposal leverages existing retail infrastructure as delivery channels and bank agents. Substantial concerns for consumers include timely transaction settlement to minimize fraud and simplified account opening procedures. Increased regulatory guidance and oversight will require inter-operability to allow consumers to operate across networks and prevent larger agent bank retailers from dominating the market. Guidance on how to structure the legal frameworks that govern the relationship of the financial institution with the agent is also critical.

Despite the foregoing, branchless banking holds great promise for fringe bank consumers and if the concerns noted herein are effectively addressed, the collaboration between retail establishments and insured financial institutions may have the ability to influence how fringe bank consumers access the formal banking economy.