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Chairman Crapo and Ranking Member Brown, members of the Committee, thank you for this opportunity to testify on "The Digitization of Money and Payments". I am a Visiting Assistant Professor of Law at Duke University School of Law, where my research focus includes consumer finance and I teach a course on fintech and financial inclusion.

The centermost issue before us is financial inclusion with respect to the U.S. payments system. The laudable interest in improving our payments system should prioritize solutions that remedy the time and access frictions facing low-income Americans. These frictions in the U.S. payments system have long been exploited in the marketplace by service providers like payday lenders and check cashers with deleterious effects on millions of Americans. In the absence of public policy solutions that truly democratize the payments system, these frictions will continue to contribute to financial fragility. In my testimony, I hope to accomplish three goals. First, I will explain how time and access frictions in the payments system impact low-income Americans. Second, I will illustrate how these frictions continue to contribute to market risks even with emerging fintech services, with a specific emphasis on early wage access programs. Accordingly, there is an urgent need to resolve the time and access frictions to improve consumer welfare. Finally, I will explain why a public banking option with existing payments infrastructure will most effectively serve the aims of financial inclusion in the immediate future.

I. The Problem: Timing and Access Frictions in the Payments System

Although established and maintained by the Federal Reserve, the U.S. payments system have privatized access points with banks as gatekeepers. Such privatization means access has long been granted to Americans based on their profitability to banks. As a result, approximately 63 million adults have limited or no access to the payments system and often resort to expensive services like money orders, check cashing, prepaid debit cards, and high-cost creditors like payday lenders.

The payments system's shortcomings were glaring in the wake of federal efforts to quickly deliver unemployment benefits and stimulus payments pursuant to the CARES Act. For example, millions of cash-strapped Americans waited weeks longer to receive paper stimulus checks than those Americans with direct deposit to their bank accounts. In the interim, they were likely to resort to high-cost creditors and upon receiving their stimulus checks, they were likely to pay up to 1.5% of it check cashing fees. Other Americans endured hours' long lines for the cheapest ATM in town to withdraw unemployment benefits on prepaid debit cards. Even some with bank accounts were unable to use their stimulus checks for living expenses because the funds were automatically used for bank overdraft charges.

These payments system frictions have long played a critical role in the financial fragility of millions of low-income Americans with disproportionate effects on Black and Latino households. Such frictions can be distilled to access and timing frictions. On access, the privatized nature of the payments system's access points—i.e., through private financial institutions—means access is often dictated by whether a person is profitable to banks. Since low-income Americans are not profitable, their access is frequently foreclosed. Specifically, minimum balance requirements, account fees, and unpredictable charges are oft cited reasons for no or severely limited access. Bank consolidations and closures have also played a role, contributing to the disproportionate number of low- and moderate-income communities without physical bank locations, particularly in rural areas. The resulting "bank deserts" curtail local economic activity by 20%. They even increase an underaged resident's risks of a poor credit profile with negative effects lasting long into adulthood.

While many bank customers may turn to online and mobile banking services as a substitute for physical branches, low-income Americans disproportionately prefer to transact with bank tellers. Moreover, online and mobile banking are not without access frictions. Although 96% of American adults have a mobile phone, approximately 19% (45 million) do not have smartphones to access online or mobile banking services. Additionally, nearly 10% (25 million) of Americans do not have alternative internet sources at home. Thus, losing physical bank locations is particularly devastating. Finally, many Americans simply distrust banks. Past experiences, particularly with unanticipated charges and check-clearing delays, leave many cautious of bank services. As a result, "unbanked" and "underbanked" Americans often use check cashing, money order and prepaid debit card services that annually deplete already limited resources for transfer services that bank customers often make for free.

On timing, for millions of Americans who live paycheck to paycheck, customary payment delays can trigger a series of late rent, past-due utility, non-sufficient fund, and overdraft charges. Indeed, such delays are estimated to cost consumers $10 billion annually in non-sufficient fund charges, late fees, and reconnection charges for utilities. In 2019, ever-increasing overdraft fees cost bank customers at the largest banks over $11 billion, 84% of which were covered by just 9% of customers. Indeed, the hardest hit bank customers each incurred nearly $1300 in overdraft fees. Timing frictions also contribute to demand for check cashing services, overdraft use, and high-cost credit like tax refund anticipation loans or payday loans, which are often advertised as making income immediately available. Many of these services impose an onerous tax on real-time payments. Others disguise cash sufficiency problems as cash flow problems to consumer detriment. For example, payday loans have been found to exacerbate financial distress and are associated with an increased risk of bankruptcy. Notwithstanding, the fringe financial industry, including payday lenders, check cashers, and pre-paid card providers, continues to collect fees of nearly $90 billion annually primarily from low-income Americans.

Inclusive and real-time access to the payments system can redistribute billions in wealth to, and in turn facilitate savings for, a cash-strapped America.

II. Early Wage Access Programs: Payment Solutions or "Fringe"Tech

The market has not solved this problem. To the contrary, there are novel "real time" payment solutions that conflate traditional notions of payment and credit services, much like payday loans. For example, the fintech sector has developed "early wage access programs" or "early-wage programs" which are mobile and internet applications that allow workers to assess and withdraw earned but unpaid wages before scheduled pay days. Providers often claim these programs are efforts to facilitate "real time" payments of wages and are analogized as being like an ATM for your paycheck. These programs are offered to consumers through mobile app stores and/or through their employers as an employee benefit. Payroll and timesheet data are collected to calculate accrued wages and early-wage transfers are typically reimbursed on the worker's next payday via a payroll deduction or pre-authorized withdrawal from their personal bank account. A growing number of employers and human resources companies partnering with early wage programs, including Walmart, Inc. and ADP Marketplace. This nascent market is rapidly growing. For example, programs that partner with employers facilitated nearly $3 billion in transfers in 2018, with 2019 figures expected to be double. In the wake of COVID-19, as Americans were furloughed and awaited stimulus checks, many of these programs experienced a surge in use. Early-wage providers anticipate demand will further spike once American are fully back to work.

Yet, although early-wage programs promise to replace high-cost credit like payday loans and overdraft protection, many state lawmakers and consumer advocates grapple over whether these programs are payment services or credit services. In my research, I find that this market in some ways resolves timing frictions in a more optimal manner than existing consumer options. For example, periodic fee structures that are often subsidized by employer partners and effectively amortize repayments can result in transfer fees, if calculated into annual percentage rates (APRs) for comparative purposes, in the range of 0% to 60%. This is a dramatic cost reduction relative to payday loans, albeit still prohibitive under several state usury statutes if deemed loan services. In other ways, however, the market poses unmitigated loan-like risks reminiscent of payday loans under the guise of real-time payments.

There are two important ways in which many early-wage programs function like payday loans. First, the programs require intertemporal decision making. Second, many programs have high fees, limited underwriting, and repayment terms similar to payday loans. On the first point, the gap in time between an early-wage transfer and a subsequent repayment on payday requires negotiating with your future self, which leads consumers to discount, albeit rationally, future costs and risks in favor of their immediate needs. On the second point, many early-wage programs can result in fees in the range of 470% APR, particularly with transaction-based or "tipping" fee structures. Such fees undoubtedly mirror payday loan costs. Additionally, the requirement that the transfer be reimbursed in full in the next payday can result in payday wages that are reduced by 25% to 50%, which may make managing other expenses extremely difficult for consumers. Arguably, as in the payday loan context, these types of features lead low-income Americans to repeatedly use early-wage programs at significant costs, including compounding program fees, overdraft charges, and late fees.

However, as purported payment services, early-wage programs enjoy limited consumer protections. On one hand, this regulatory reality poses few concerns when programs are free or subsidized, particularly in the employer context. The drawback is mostly with respect to access. These programs are inaccessible for consumers who do not have mobile, broadband, or bank account access or whose employers do not offer the programs. Additionally, when "real time" access is for income like unemployment benefits or a stimulus check, these programs are of little value. On the other hand, for programs with less favorable and opaque repayment terms, this regulatory reality poses substantial risks that are fully borne by consumers who lack full information. Consequently, pending state class action lawsuits, online consumer reports, and investigative reports reveal a growing number of consumers who spiraled into more precarious financial conditions unaware that these payment services functioned much like loans.

The emerging early-wage access market deserves distinct regulatory attention to adequately mitigate its risks and foster its benefits. However, this example illustrates that some "real time" payment solutions disguise cash sufficiency problems as cash flow problems to consumer detriment with increasing popularity in the wake of COVID-19. To the extent market solutions can resolve timing issues, they face significant limitations and access frictions. Inclusive and real-time access to the payments system could foster greater regulatory clarity between mere payment services and services that present loan-like risks for consumers. It could facilitate real-time access to income other than wage payments, including social security, unemployment, and stimulus benefits. Finally, such access could also reduce or eliminate costs for real-time wage payments, and appropriately shift firm focus to wage sufficiency rather than wage timing.

III. An Open Access Solution

According to the Federal Reserve Board Governor Lael Brainard, "Everyone deserves the same ability to make and receive payments immediately and securely, and every bank deserves the same opportunity to offer that service to its community." This ethos is in keeping with the long-standing principle that the Federal Reserve Board's ("Fed") provision of payments system is for the public benefit. But for *everyone* to truly benefit from the payments system, the access points must meet people where they are. If financial distress arising from job loss, reduced incomes, depleted savings, and increased expenses in the wake of COVID-19 is disproportionately exacerbated for low-income Americans due to payment system frictions, it is clear that time is of the essence in addressing our payments system problem.

The simplest near-term solution is likely public access to the existing payments system. As a technical matter, the dollar is already digital in the existing payments system via credit and debit payments, wire transfers, and ACH payments. This system has long been publicly supported and subsidized, but not publicly available. Yet, our monetary system is a public good. In an increasingly digitized marketplace where the timing of money plays a crucial role in household financial security, payments systems are necessary for effective use of that good. And because the payments infrastructure is ubiquitous, public access to it may be the quickest way to achieve financial inclusion to address pressing economic concerns.

There are several ways Congress in coordination with the Federal Reserve Board (Fed) could accomplish that goal. [For example, the Fed could issue reloadable, zero-fee prepaid debit

cards available to all Americans. This is likely to be the least onerous option. Such cards could be issued in coordination with federal agencies that make payments to citizens, including social security benefits, tax refunds and stimulus payments. With this option, ensuring there are zero transaction costs (including for out-of-network ATMs and direct deposits) and adequate protections for Americans will be essential for its viability. However, funds stored on the card are unlikely to be protected from loss. Alternatively, the Fed could more ambitiously provide bank accounts to all Americans. Prominent examples include a Fed-based postal bank account with debit card access, a Fed-based digital account called FedAccounts with digital wallet access, or as with Ranking Member Brown's recent bill, a combination of the two. These account-based proposals would fully protect account funds and provide millions of low-income Americans significantly more accessible, timely, and trustworthy services. With respect to Fed-based postal bank accounts, the coordination between the Federal Reserve and the USPS would be complimentary since these institutions both have a history of privacy protection and a public-serving mandate.

There are likely to be *de minimis* cost and geographic barriers to access, particularly with prepaid debit cards, post office locations and Fed-issued debit cards. To the extent a public option is limited to only digital wallets, there will be access concerns for nearly 45 million Americans that do not have smartphones. FedAccounts coupled with postal banking are likely to reduce demand for deleterious services that offer quick or "real time" access to cash at relatively high costs, including check cashing services, payday loans, and some early-wage programs.

These are just some examples of ways Congress could provide for inclusive and real-time payments in the more immediate future to facilitate quick transfers of government funds (including future payments) with minimal transaction costs for Americans whose resources are already severely limited.

Conclusion

In conclusion, I offer a brief observation on novel payments technology, namely blockchain-based central bank digital currency ("CBDC") and stablecoins. In just 15 months' time, the Bank for International Settlements (BIS) made a 180-degree position change on CBDCs, stating the digital currencies could amount to a "sea change." Also, a working group of central banks, including the Fed, are rigorously and optimistically researching their utility. There is no doubt that such technology promises to revolutionize our understanding of money. Any CBDC is likely to take significant time to develop and make safe, interoperable, and ubiquitous for public use. However, the development of such a payments system and the near-term proposals I have discussed are not mutually exclusive. To the contrary, as the Fed has done in the past, wide-spread of adoption of accounts-based solutions like FedAccounts can in turn be leveraged to foster such innovation and facilitate faster adoption of such a CBDC if realized.

Yet, with respect to both Congress must critically review innovations like CBDCs and stablecoins to ensure novel forms do not belie true functions. In terms of financial inclusion, this means ensuring that promises of open access are achievable and ultimately achieved. To serve that end, I propose the following inquiries. Is there evidence that this new solution will work to increase access? What are the use cases for rural and low-income communities? Are there financial or physical barriers to access? If services are "free", what alternative tradeoffs are consumers making

(e.g., consumer data)? Is consumer data being used to exploit behavioral weaknesses to their detriment? Additionally, are consumer conditions improved by a shift to the novel solution? Ultimately, fintech solutions should not merely move the most Americans from the fringe financial marketplace to a fringe digital economy.