

BLACKLISTED: THE UNWARRANTED DIVESTMENT OF ACCESS TO BANK ACCOUNTS

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The ability to thrive in America's mainstream financial economy is intertwined with the ability to maintain a bank account. Yet, recent studies show that millions of American families do not own a bank account. While studies have pointed to various reasons behind this phenomenon, relatively little attention has been given to the banking industry's own exclusionary policies regarding bank accounts. This Note critiques financial institutions' use of an obscure credit reporting agency called ChexSystems. A bank reports an account to ChexSystems if it deems the account to be a "problem." Each bank has discretion as to what constitutes a "problem" account. Research has shown that this discretion has permitted banks to report accounts to ChexSystems for very modest sums. Problematically, if an applicant appears in ChexSystems when attempting to open a new account, evidence has shown that most banks would deny that applicant a checking account for a five-year period, effectively blacklisting the applicant from mainstream financial institutions. In turn, these rejections force many families to rely on expensive alternatives to meet their day-to-day financial needs. In this Note, James Marvin Pérez posits that we must seriously question the banking industry's use of ChexSystems. In light of historical banking practices, Mr. Pérez argues that ChexSystems may act as a pretext for discriminatory behavior among banks to exclude unwanted clientele. Additionally, Mr. Pérez explains that ChexSystems disproportionately punishes many consumers who have made only trivial mistakes. He offers additional factors for a bank to consider other than an applicant's ChexSystems report when evaluating that applicant for an account. Finally, exploring federal legislation, Mr. Pérez ultimately advocates employing the Community Reinvestment Act (CRA) as a legislative tool to combat the apparent deficiencies with ChexSystems in order to bring millions of families back into America's mainstream financial economy.

INTRODUCTION

In August 2000, the front page of the Wall Street Journal headlined an article entitled, *It's Not in the Mail: Bounce a Check, and You Might Not Write Another for 5 Years; Banks Are Using Database to Blacklist Customers for Even Small Slip-Ups; Do the Poor Get Hurt*

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More? (“WSJ article”).¹ The database mentioned in the headline is managed by ChexSystems, Inc., a national credit bureau (or “credit reporting agency”)² that tracks consumers’ financial histories with respect to their checking accounts. By detailing consumers’ stories about how a single negative ChexSystems report barred them from opening or maintaining a checking account at most U.S. banks for a period of five years, the WSJ article exposed ChexSystems as one of the banking industry’s best kept secrets.

Prior to the publication of the WSJ article, most people had never heard of ChexSystems, much less realized that their personal banking activities could be reported to a credit reporting agency.³ But in the weeks and months that followed the WSJ article, the public became increasingly concerned about the possibility that the banking industry was exploiting the ChexSystems database, and community groups began to demand that banks change their ChexSystems policies to avert unwarranted exclusions from checking accounts.⁴

Five years later, however, little has changed.⁵ ChexSystems has continued to provide banks with a powerful tool to exclude consumers

¹ Paul Beckett, *It's Not in the Mail: Bounce a Check, and You Might Not Write Another for 5 Years; Banks Are Using Database to Blacklist Customers for Even Small Slip-Ups; Do the Poor Get Hurt More?*, WALL ST. J., Aug. 1, 2000, at A1.

² A credit reporting agency (or “credit bureau”) is a business that collects and sells financial and credit information about individual consumers. Credit bureaus do not grant credit to anyone; rather, they collect enormous quantities of information on consumers and condense the information into consumer credit reports (also called consumer reports) which they then resell to third parties, such as potential creditors—banks, retailers and other lenders.

Anthony Rodriguez Et Al., FAIR CREDIT REPORTING 3-4 (5th ed. 2002).

³ See Beckett, *supra* note 1 (giving examples of bank customers caught by surprise when rejected by other banks). Partly due to a lack of wide public knowledge about ChexSystems, virtually no studies have examined ChexSystems in great detail. See Martin H. Bosworth, *Chex Imbalances: ChexSystems and the War of Banking Rights*, ConsumerAffairs.com, Mar. 17, 2005 (noting that “getting direct information about [ChexSystems] is roughly equivalent to oil-wrestling a contortionist in a frictionless body stocking. There is almost no direct way to contact the company, or to find reliable information about its practices”), <http://www.consumeraffairs.com/finance/chex01.html>. Nevertheless, this Note draws on a vast amount of anecdotal evidence and historical patterns to suggest and critique how some banks may be—or, at a minimum, could be—employing ChexSystems. What is known about ChexSystems (and banks’ use of it) suggests that the question is not so much whether there is an abuse of discretion, but rather the *extent* of this abuse. Through this critique, this Note hopes to prompt further research on the database, the way the banking industry employs it, and which groups are most affected by it.

⁴ See Paul Beckett, *Banks to Rethink System Used to Approve Applicants Opening Checking Accounts*, WALL ST. J., Aug. 17, 2000, at A12.

⁵ See Kathy Chu, *Identity Theft Could Impede Victims’ Banking*, WALL ST. J., Oct. 26, 2004, at D2 (noting that “vast majority of banks, including J.P. Morgan Chase & Co., Bank of America Corp., Citigroup Inc., and Wells Fargo & Co., [continue to] rely upon ChexSys-

from bank accounts, even as those same banks have expanded to become larger and more influential social actors.⁶

This would not be troubling except for the fact that, in our modern economy, access to a bank account is essential to the economic empowerment of households and communities. Being “unbanked” impedes a consumer’s ability to become self-sufficient by hampering her ability to save for the future,⁷ establish a favorable credit history,⁸ or cash checks without resorting to expensive alternatives.⁹ More generally, because access to a bank account is a prerequisite to making financial investments and engaging in sound money management, a bank account serves as a critical entry point “to becom[ing] familiar with the fundamental concepts that are critical in asset building.”¹⁰ As Senator Joseph Lieberman has put it, “To be unbanked is to be under an economic disadvantage.”¹¹ Yet, even in

tems to screen customers”); Bosworth, *supra* note 3 (“[ChexSystems] is still operating generally free of public oversight.”).

⁶ See Chu, *supra* note 5. Notably, some banks have moved to more sensible ChexSystems policies. See *infra* note 217. However, these efforts are voluntary, and many banks continue to exploit ChexSystems. Likewise, for those banks that have adopted more sensible ChexSystems policies, the potential exists for these banks to revert back to their prior practices, see *infra* Part III (discussing problems with banks’ use of ChexSystems database).

⁷ While it is true that low-income families, by definition, have little to save, studies have confirmed that these families are capable of saving if given the means to do so. See, e.g., Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 137–38 (2004) (providing examples of low-income savings patterns and anecdotes); Lynn Elaine Browne, *Changing Financial Markets and Community Development: An Overview*, in CHANGING FINANCIAL MARKETS AND COMMUNITY DEVELOPMENT: A FEDERAL RESERVE SYSTEM COMMUNITY AFFAIRS RESEARCH CONFERENCE 20, 24 (Jackson L. Blanton et al. eds., 2001) [hereinafter CHANGING FINANCIAL MARKETS] (reporting that, with Individual Development Accounts (IDAs), “the very poorest actually saved larger shares of their income than the less poor”), http://www.chicagofed.org/cedric/changing_financial_markets_session1.cfm; MICHAEL A. STEGMAN ET AL., CTR. FOR CMTY. CAPITALISM, THE IMPACTS OF IDA PROGRAMS ON FAMILY SAVINGS AND ASSET-HOLDINGS, (Feb. 19, 2001) http://www.kenaninstitute.unc.edu/centers/CCC/CCC_publications/ADD.pdf (noting that “evidence here suggests not only that low-income people can save, but that the resources offered by IDA programs are effective in helping people get into the habit of saving”). For more about IDAs and how to improve them, see generally CTR. FOR CMTY. CAPITALISM, FINANCIAL INSTITUTIONS AND INDIVIDUAL DEVELOPMENT ACCOUNTS: RESULTS OF A NATIONAL SURVEY (Oct. 2003), http://www.kenan-flagler.unc.edu/assets/documents/CC_Financial_Institutions_and_IDAs.pdf.

⁸ See Peter P. Swire, *Equality of Opportunity and Investment in Creditworthiness*, 143 U. PA. L. REV. 1533, 1545 (1995).

⁹ See *infra* notes 52–56 and accompanying text.

¹⁰ *Serving the Underserved: Initiatives to Broaden Access to the Financial Mainstream: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the House Comm. on Fin. Servs.*, 108th Cong. 7 (2003) (statement of Wayne Abernathy, Assistant Sec’y for Fin. Insts., Dep’t. of Treasury).

¹¹ Joseph I. Lieberman, *Foreword* to MICHAEL A. STEGMAN, SAVINGS FOR THE POOR: THE HIDDEN BENEFITS OF ELECTRONIC BANKING ix (1999).

an era of “personal responsibility”¹² and “equal opportunity,”¹³ more than 22 million American households, comprised of 56 million individuals, lack this basic microeconomic tool.¹⁴

Today, although a bank account is perhaps as important as “electricity, running water, and a telephone,”¹⁵ ChexSystems currently maintains negative records on more than 19 million checking accounts.¹⁶ In turn, a significant portion of the banking industry has relied on these ChexSystems records to deny, sometimes unjustifiably, checking accounts (and occasionally savings and credit accounts) to those appearing in the database.¹⁷ Although there are numerous reasons why certain consumers choose to manage their financial lives outside mainstream banks,¹⁸ former accountholders who have been

¹² See Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), 42 U.S.C. § 601 (2000) (act designed, in part, to “end the dependence of needy parents on government benefits”).

¹³ See Equal Credit Opportunity Act (ECOA), 15 U.S.C. §§ 1691–1691f (2000) (act defining and prohibiting credit discrimination).

¹⁴ See U.S. GEN. ACCOUNTING OFFICE, ELECTRONIC TRANSFERS: USE BY FEDERAL PAYMENT RECIPIENTS HAS INCREASED BUT OBSTACLES TO GREATER PARTICIPATION REMAIN 57 fig. 9 (2002) [hereinafter GAO REPORT], available at <http://www.gao.gov/new.items/d02913.pdf>. Reasons vary as to why millions of Americans do not hold a bank account. See *infra* note 18.

¹⁵ Michael A. Stegman et al., *Toward a More Performance-Driven Service Test: Strengthening Basic Banking Services under the Community Reinvestment Act*, 9 GEO. J. ON POVERTY L. & POL’Y 405, 405 (2002).

¹⁶ See eFUNDS, INC., 2004 ANNUAL REPORT 3 (2005), <http://library.corporate-ir.net/library/12/122/122648/items/148857/EFUNDS%2004AR.pdf>; Beckett, *supra* note 4 (reporting figures in year 2000 as seven million); Eileen Alt Powell, *Payback for Rubber Checks: Banks Deny New Accounts for Names on Overdraft Registry*, J. GAZETTE (Fort Wayne, Ind.), Mar. 30, 2004, at 7B (referring to Rahul Gupta, senior vice president of eFunds Corp., parent company of ChexSystems, as estimating figure to be seven to ten million). But see John W. Connery, *Using Account Verification Systems Effectively*, in FED. RESERVE BANK OF CHI., PROFITWISE 10, 11 (2002) (estimating figure at 22 million).

¹⁷ See *infra* Part II.

¹⁸ See, e.g., Arthur B. Kennickell et al., *Recent Changes in U.S. Family Finances: Results from the 1998 Survey of Consumer Finances*, 86 FED. RES. BULL. 1, 9 (2000) (reporting conclusions from survey), <http://www.federalreserve.gov/pubs/bulletin/2000/0100lead.pdf>; ELAINE KEMPSON ET AL., UNIV. OF BRISTOL, POLICY LEVEL RESPONSE TO FINANCIAL EXCLUSION IN DEVELOPED ECONOMIES: LESSONS FOR DEVELOPING COUNTRIES 1 (2004), http://www.pfrc.bris.ac.uk/research/dfid_report.pdf. The authors note:

There is no single cause and although refusal by banks to open accounts is a problem[,] it is by no means the main cause Instead a range of factors act to deter or prevent some people from opening and using a bank account for their day-to-day money management. These include identity requirements, terms and conditions, charges, physical access problems and psychological barriers.

Id. at 1.

“blacklisted” on account of their ChexSystems report unquestionably constitute a significant segment of the nation’s unbanked consumers.¹⁹

While it appears at first blush that the industry uses ChexSystems just like a creditor would use any credit bureau, ChexSystems differs from traditional credit reporting in two significant ways. First, a single report from a bank to ChexSystems, sometimes for a minor infraction, is often sufficient to blacklist a consumer from the banking industry.²⁰ Many banks have construed an applicant’s mere *presence* in the ChexSystems database as the sole factor in assessing whether or not the applicant is an acceptable credit risk to open a checking account.²¹ This treatment is a disproportionate punishment for many former accountholders who have made only trivial mistakes (like bouncing a single check) while managing their checking accounts. Second, in spite of the severe consequences, banks have total discretion as to whether to place consumers into the ChexSystems database. Customers can be (and are) reported for offenses ranging from suspected fraud to failing to pay overdraft charges within an allotted time.²² Some critics fear that, given this unbridled discretion, banks have employed the ChexSystems database as a pretext to eliminate their lower tier or “unwanted” clientele.²³

Astonishingly, despite recent efforts to “bank the unbanked,” federal and local regulators have taken no firm action to guarantee that the banking industry has not abused the ChexSystems database. Consequently, much of the banking industry has continued to employ ChexSystems with little regulatory oversight and no obligation to consider the public welfare. This Note argues that this practice is unacceptable, and that the industry’s unchecked discretion to place consumers on the ChexSystems network as well as its perfunctory decisions to reject applicants based solely on the existence of a

¹⁹ To be clear, the 19 million consumers who are in the ChexSystems database do not necessarily constitute 19 million of the nation’s unbanked consumers. Many reasons explain why the numbers do not exactly match up. For example, presumably, some portion of these consumers on ChexSystems will have a checking or savings account through banking institutions that do not employ ChexSystems to screen applicants. *See infra* Part II (explaining ChexSystems network).

²⁰ *See, e.g.*, Beckett, *supra* note 1; Beckett, *supra* note 4; Connery, *supra* note 16, at 15; NAT’L CMTY. REINVESTMENT COALITION, CHEXSYSTEMS: DISENFRANCHISEMENT OR RISK MANAGEMENT TOOL? 3 (2001) [hereinafter NCRC REPORT], www.ncrc.org/policy/cra/ChexSystemsReport.rtf; NAT’L CMTY. INVESTMENT FUND, RISK MANAGEMENT STRATEGIES FOR NEW ACCOUNTS: RFSI PARTICIPANTS SHARE THEIR EXPERIENCES 2 [hereinafter NCIF REPORT], http://www.cfsinnovation.com/managed_documents/ncif_risk.pdf (last visited June 30, 2005).

²¹ *See supra* note 20.

²² *See* Beckett, *supra* note 1.

²³ *See, e.g., id.*; Jane Bryant Quinn, *Checking Error Could Land You on Blacklist*, WASH. POST, Sept. 30, 2001, at H2.

ChexSystems file unquestionably works against—indeed, mocks—the goal of banking our millions of unbanked families.

Part I provides the background necessary to understand the societal costs of the ChexSystems network. It focuses attention on the spoiled relationship between the banking industry and low-income communities—a population that ChexSystems likely affects most directly. In the same vein, Part I also surveys major legislative attempts to bank the unbanked, and concludes that federal and state legislatures have strong incentives—and, in many cases, a strong desire—to ensure that the unbanked have access to mainstream financial institutions. Part II presents a detailed description of the ChexSystems network.

With the backdrop provided in Parts I and II, Part III offers criticisms of ChexSystems, and concludes that the industry's use of ChexSystems is overinclusive and acts as a disproportionate punishment for many former accountholders. More disturbing still, this Note suggests that ChexSystems may be operating as a pretext for discriminatory behavior on the part of banks or their employees. Finally, Part IV examines relevant federal legislation and, ultimately, advocates using the Community Reinvestment Act (CRA) as a vehicle to restrain the banking industry's exploitation of ChexSystems. By offering this suggestion, this Note hopes to point federal regulators and community-based organizations (CBOs) towards meaningful solutions to ensure that banks will no longer exploit the ChexSystems database to society's detriment.

I

BANKING SERVICES AND LOW-INCOME COMMUNITIES

As society moves further into an era of “electronic money,”²⁴ it is easy to see that a bank account is worth more than simply the dollars and cents that we store in it. In our modern economy, a bank account serves three primary functions: (1) to convert checks into money; (2) to serve as a payment system to third parties; and (3) to provide security for savings,²⁵ eliminating the need to carry large amounts of cash, which in turn reduces the chances of being robbed.²⁶ A bank

²⁴ The term “electronic money” refers to electronic payment systems. See generally FED. RESERVE BANK OF CHI., ELECTRONIC MONEY, http://www.chicagofed.org/consumer_information/electronic_money.cfm (last visited June 30, 2005).

²⁵ Constance R. Dunham, *The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities*, in CHANGING FINANCIAL MARKETS, *supra* note 7, at 31, 35.

²⁶ See DAVID R. WARWICK, ENDING CASH: THE PUBLIC BENEFITS OF FEDERAL ELECTRONIC CURRENCY 9 (1998) (“Crime[, such as robbery,] in America is largely interwoven with cash.”).

account's savings feature is particularly important for low-income families seeking to move into the middle class. As Belsky and Calder note, "Savings provide economic security, help households avoid the steep costs of short-term credit, and are stepping stones to investments in other assets."²⁷

In many ways, a consumer's ability to maintain a healthy relationship with a banking institution is the foundation of modern American commerce. Much of this transformation can be linked to how modern technology has transformed a bank account's functions.²⁸ At retail stores, for example, bank debit cards are now perhaps more common and more secure than cash.²⁹ Perhaps more significantly, with the rise of the Internet, online banking has made everything from direct deposit to paying bills to applying for home or educational loans easily accessible and instantaneous.³⁰ As the demand for convenient and low-cost accounts grows, many traditional banks have opened Internet-only branches that provide the advantages of 24-hour, at-home banking.³¹ Because Internet-only banking markedly reduces costs for financial institutions, some have suggested that this mode of banking may be the key to banking low-income consumers³² who have

²⁷ See Eric Belsky & Allegra Calder, *Credit Matters: Low-Income Asset Building Challenges in a Dual Financial Service System 2* (Joint Ctr. for Hous. Studies, Harv. Univ., Working Paper No. BABC 04-1, 2004), available at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-1.pdf.

²⁸ See generally CHRISTOSLAV E. ANGUELOV ET AL., U.S. CONSUMERS AND ELECTRONIC BANKING, 1995-2003 (2004), http://www.federalreserve.gov/pubs/bulletin/2004/winter04_ca.pdf.

²⁹ See FED. RESERVE SYS., THE 2004 FEDERAL RESERVE PAYMENTS STUDY: ANALYSIS OF NONCASH PAYMENTS TRENDS IN THE UNITED STATES: 2000-2003, at 3 (2004) ("The annual number of payments initiated by cards (credit card, debit card, and EBT) increased 11.0 billion between 2000 and 2003, for an annual growth rate of 13.2 percent. Debit cards, in particular, have experienced even greater growth rates . . ."), <http://www.frbservices.org/Retail/pdf/2004PaymentResearchReport.pdf>.

³⁰ MICHAEL A. STEGMAN, SAVINGS FOR THE POOR: THE HIDDEN BENEFITS OF ELECTRONIC BANKING 42 (1999) ("Online banking has increased[,] . . . jumping 78 percent in 1997, to 4.8 million, and by a similar rate in 1998, to about 7.8 million. Most of the forecasts for electronic banking predict that growth will continue . . ." (internal citations omitted)). By 1999, "more than 400 banks and 225 credit unions [were] online," twice as many as in 1997. See *id.* at 43. Some banks conduct their business exclusively online. See *id.* Online banking has also drastically decreased transaction costs for banks. *Id.* at 41 ("The overhead cost of an online banking system is expected to be about a half to a third of the cost of today's branch-dominated retail banking operation.").

³¹ See Jennifer Maree, *Banking in the 21st Century: Cyberspace and Internet Banks—Redefining Compliance with the Community Reinvestment Act*, 119 BANKING L.J. 795, 797 (2002).

³² See Barr, *supra* note 7, at 128, 225-27 (arguing for government incentives for low-cost electronic accounts). The reduced costs of Internet banking compared to traditional services are encouraging:

[A] transaction completed at a branch office costs the bank \$1.07 and a transaction by mail is 73 cents. By contrast, remote access services provide cheaper

normally been perceived as an unprofitable clientele.³³ Taking advantage of this rise in Internet transactions, federal and state governments have begun processing benefit payments electronically through bank accounts in order to capture some of these cost savings.³⁴ These efforts require that benefit recipients maintain access to a bank account in order to take advantage of electronic payment systems.

Additionally, access to a bank account allows accountholders to practice financial prudence and develop long-term wealth. Banked consumers have a more effective means at their disposal to budget their spending habits, earn interest on their deposits, and provide an official record of their financial history—all of which are indications of financial well-being that lenders consider pertinent to assessing a loan applicant's creditworthiness.³⁵ Since creditors are "skeptical of down payments made with 'mattress money,'"³⁶ banked consumers have greater opportunities to obtain consumer credit.³⁷ Economist John Caskey shows that "[w]hile 63 percent of households with deposit accounts had bank credit cards, only 5 percent of those without accounts did."³⁸ Consumer credit, in turn, permits families to capitalize on their future earnings and build long-term assets,³⁹ whether by securing a mortgage,⁴⁰ financing a car loan, or taking out an education loan. After controlling for other factors, studies confirm that consumers who hold bank accounts own significantly more assets than

options for banks. The unit cost of a telephone transaction is 54 cents and an ATM transaction costs 27 cents. However, banking via the Internet is markedly less expensive . . . with transaction costs at about one cent each.

Maree, *supra* note 31, at 797 (citing Robert Keene, *Don't Let Costs Drive Customers Away*, AM. BANKER, May 14, 1999, at 7).

³³ See Barr, *supra* note 7, at 183 (noting that "banks doubt that accounts tailored to low-income individuals will be profitable").

³⁴ See *infra* Part I.C (describing state and federal banking initiatives).

³⁵ See Swire, *supra* note 8, at 1545. Swire notes:

The lack of a checking account will typically mean a less clearly documented financial history, making it more difficult for the borrower to answer a lender's demands for information. The absence of clear records that a checking account generates makes it more difficult for a borrower to keep track of what bills have been paid, increasing the likelihood of missed payments.

Id.

³⁶ *Id.* at 1546.

³⁷ STEGMAN, *supra* note 30, at 1.

³⁸ JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 72 (1994).

³⁹ Belsky & Calder, *supra* note 27, at 14–15 (noting that while "many households can expect their incomes to grow over time, debt can be a way to begin to build assets earlier in life").

⁴⁰ See generally Raphael W. Bostic et al., *Hitting the Wall: Credit as an Impediment to Homeownership* (Joint Ctr. for Hous. Studies, Harv. Univ., Working Paper No. BABC 04–5, 2004) (discussing importance of credit to homeownership), available at http://www.jchs.harvard.edu/publications/finance/babc/babc_04–5.pdf.

those who do not.⁴¹ Finally, unbanked consumers are less likely to hold any type of retirement account.⁴² All these factors are vital to strengthening a family's economic self-sufficiency, thereby making a bank account particularly necessary for low- and moderate-income households.

A. A Survey of the Unbanked

According to the U.S. General Accounting Office ("GAO"), it is estimated that 51% of adults earning less than \$15,000 per year and 36% of adults earning in the range of \$15,000 to \$30,000 per year lack a basic bank account⁴³—compared to 17% for adults earning at least \$45,000 per year.⁴⁴ Unbanked consumers also tend to have lower levels of education, with 69% obtaining only a high school education or less.⁴⁵

Along racial lines, the U.S. minority population represents over 39% of the nations' unbanked.⁴⁶ Astonishingly, the GAO reports that 52% of African-American adults and 50% of Hispanic adults are without bank accounts.⁴⁷ These figures compare to 21% for white adults and 34% for the rest of the population who are unbanked.⁴⁸

⁴¹ See Michael Sherraden & Michael S. Barr, *Institutions and Inclusion in Saving Policy* 25 (Joint Ctr. for Hous. Studies, Harv. Univ., Working Paper No. BABC 04-15, 2004) ("After controlling for key factors[,] . . . low-income households with bank accounts were 43 percent more likely to have other financial assets than households without bank accounts."), available at http://www.jchs.harvard.edu/publications/finance/babc/babc_04-15.pdf.

⁴² Stegman et al., *supra* note 15, at 406 (noting that in 1998, only eight percent of unbanked families had retirement accounts compared to fifty-three percent of other households).

⁴³ See GAO REPORT, *supra* note 14, at 57 fig. 11. For definition of "basic bank account" (also referred to as "lifeline account"), see *infra* notes 75-77 and accompanying text.

⁴⁴ See GAO REPORT, *supra* note 14, at 57 fig. 11; see also KEMPSON ET AL., *supra* note 18, at 2 ("Countries with the highest levels of inequality, also have the highest levels of banking exclusion."). In contrast, Canada enjoys a 3% unbanked population among the general population, and an 8% unbanked population among low-income households. See Can. Cmty. Reinvestment Coalition, *Access to Basic Banking Service: Ensuring a Right to this Essential Service*, (Can. Cmty. Reinvestment Coalition, Position Paper No. 2, Oct. 1997), available at <http://www.canrc.org/english/access.html>.

⁴⁵ See GAO REPORT, *supra* note 14, at 58 fig. 12.

⁴⁶ See *id.* at 59 fig. 13. *But see* MAUDE TOUSSAINT-COMEAU & SHERRIE L.W. RHINE, INCREASING PARTICIPATION IN MAINSTREAM FINANCIAL MARKETS BY BLACK HOUSEHOLDS 1 (Fed. Reserve Bank of Chi., Consumer Issues Res. Series No. 2000-4, 2000) (estimating that 57% of unbanked are minority households), available at <http://www.chicago.fed.org/publications/publicpolicystudies/ccapolicystudy/pdf/cca-2000-4.pdf>. Disparities are greater in some regions. In Los Angeles, for example, Stegman reports that Hispanics represent over 70% of the unbanked. STEGMAN, *supra* note 30, at 24.

⁴⁷ See GAO REPORT, *supra* note 14, at 59 fig. 13.

⁴⁸ See *id.*

Moreover, in some states, Stegman finds that an estimated 75% of individual welfare recipients lack a basic bank account,⁴⁹ essentially leaving these families “locked into a life of frustrating poverty.”⁵⁰

B. Fringe Banking

Lacking access to traditional banking services, the unbanked and “underbanked”⁵¹ turn to the fringe banking industry (or alternative financial services (AFSs)) to meet their daily financial needs.⁵² AFSs primarily consist of check-cashing outlets (CCOs), pawnshops, payday lenders, and rent-to-own shops.⁵³ Aside from converting paychecks into cash, CCOs commonly sell money orders and wire-transfer services.⁵⁴ Studies confirm that unbanked consumers use these services. In one study, for example, 71% of the unbanked converted their paper checks into cash through CCOs, and 83% paid bills by money orders or cash.⁵⁵ Since the unbanked are also likely to be without credit cards, many turn to pawnshops and payday lenders to meet their short-term credit needs, and to subprime lenders to meet their long-term credit needs. Two features of this “cash-and-carry” method of banking, however, distinguish it from traditional banking: (1) an apparent lack of a regulatory structure and (2) higher service costs, prompting some to label the fringe banking industry “the ultimate

⁴⁹ See STEGMAN, *supra* note 30, at 24 (referring to California).

⁵⁰ *Banking Services in Low- and Moderate-Income Communities: A Two-Tiered Financial Services System? Before Subcomm. on Consumer Credit & Ins. of the Comm. on Banking, Fin., & Urban Affairs*, 103d Cong. 1 (1994) (statement of Hon. Joseph P. Kennedy, chairman of subcommittee).

⁵¹ The term “underbanked” refers to “those with an account at a depository institution but who also rely for their financial services on other financial services providers (such as check cashers, payday lenders, auto title lenders, refund anticipation lenders, and rent-to-own companies) that largely serve low- and moderate-income neighborhoods.” Barr, *supra* note 7, at 130 n.16.

⁵² See generally CASKEY, *supra* note 38 (examining roles that fringe banks play in financial system).

⁵³ Of these services, a payday loan is the only service that requires a bank account.

Payday loans are short-term cash loans based on personal checks held for future deposit or electronic access to the borrower’s bank account. Borrowers write a personal check for the amount borrowed plus the finance charge and receive cash. Lenders hold checks until the next payday when payment is due. Borrowers can redeem the check for cash, allow the check to be deposited, or pay the finance charge to roll the loan over for another pay period.

N.Y. Pub. Interest Research Group, Consumer Project, *Loan Sharks in the Water: Payday Lending*, <http://www.nypirg.org/consumer/payday/default.html> (last visited May 16, 2005).

There is also evidence that banked consumers use fringe banking services on a discretionary basis. See CASKEY, *supra* note 38, at 78.

⁵⁴ See CASKEY, *supra* note 38, at 1.

⁵⁵ See Dunham, *supra* note 25, at 36, 38.

pimp of our communities.”⁵⁶ The next Section briefly outlines government responses—or, more accurately, the lack thereof—to the problems associated with the fringe banking industry.

1. *Fringe Banking Regulation*

In the wake of banking deregulation during the 1980s, the fringe banking industry exploded into low-income, urban communities to fill the gap that banks created when they abandoned these communities to focus their services on more profitable, higher-income consumers.⁵⁷ Today, “the fringe banking industry has become increasingly sophisticated as large national chains have replaced independently owned and operated stores.”⁵⁸ The industry reports net revenues of \$1.5 billion in fees per year.⁵⁹ Ironically, to capture some of these revenues, mainstream banks have begun to open or partner with independent check-cashing chains in the very communities that they once abandoned.⁶⁰

Despite the explosion into these communities, fringe banks went virtually unnoticed by federal or state regulators during this same period.⁶¹ Even today, the federal government provides no specific

⁵⁶ Tony LaRussa, *Bill Targets Outlets for Check-Cashing*, PITTSBURGH TRIB.-REV., Dec. 15, 2004 (statement of Valerie McDonald Roberts, Allegheny County Recorder of Deeds), available at http://www.pittsburghlive.com/x/tribune-review/pittsburgh/s_283449.html. Caskey notes, “[F]ringe banks thrive by serving customers who are excluded from mainstream financial institutions and by differentiating their services from those of banks.” CASKEY, *supra* note 38, at 2.

⁵⁷ Caskey notes:

The resulting increase in competitive pressures [of the deregulation] forced banks to pay higher interest rates to attract large deposits and to eliminate some money-losing services that they had previously cross-subsidized, such as the provision of low-cost, small-balance checking accounts. The increased cost of small-balance deposit accounts encouraged many households with limited financial savings to abandon the banking system. And, in response to competitive pressures, banks closed unprofitable or marginally profitable branches, many of which were in low-income areas. These developments combined to spur the demand for fringe banking services.

CASKEY, *supra* note 38, at 8.

⁵⁸ *Id.* at 2. As Professor Barr notes, “Today, there are almost 10,000 stores in the U.S. that classify their primary line of business as check cashing, about double the number there were six years ago, and almost five times the number there were fifteen years ago.” Barr, *supra* note 7, at 142.

⁵⁹ See Barr, *supra* note 7, at 142.

⁶⁰ See Fannie Mae Found., *From Competition to Collaboration: Examples of Bank/Check Casher Relationships*, BUILDING BLOCKS (2002), available at <http://www.fanniemae.foundation.org/programs/bb/v3i3-competition.shtml> (last visited May 16, 2005); STEGMAN, *supra* note 30, at 71–80; see generally Steven B. Potter, *Befriending Payday and Small Loan Businesses—A Smart Move for the Banking Industry?*, 119 BANKING L.J. 636 (2002) (discussing relationship of banks to payday loan industry).

⁶¹ See CASKEY, *supra* note 38, at 9–10.

regulatory structure for a large part of this market.⁶² Although states generally do impose some regulations on CCOs, few states “devote meaningful resources to enforcing the[se] regulations,”⁶³ and a handful do not even have meaningful regulations to enforce.⁶⁴ Although states’ usury laws sometimes offer consumers protection against unscrupulous practices, fringe banks have managed to bypass these laws by associating themselves with national banks, which, pursuant to Office of the Comptroller of the Currency (OCC) regulations, are exempt from most state regulations.⁶⁵

2. *The Cost of Fringe Banking*

Financial services are not exempted from the universal rule that the poor pay more for goods and services.⁶⁶ Partly explained by an incompetent regulatory structure, fringe banking services are staggeringly expensive. In most areas, a worker bringing home an annual income of just \$12,000 can expect to mete out \$250 per year simply to convert her paper check to cash.⁶⁷ Other check-cashing services, such as money orders and wire transfers, inflate the burden of being

⁶² See *id.* at 10; Barr, *supra* note 7, at 141, 148, 158, 173 (discussing regulation of alternative financial sector); Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 725–26 (2004) (arguing for federal legislation to address insufficiency of “patchwork of state laws”).

⁶³ See, e.g., CASKEY, *supra* note 38, at 10. Caskey explains: “Undoubtedly, much of the disparity between the resources devoted to consumer protection in mainstream financial markets and those devoted to regulating and monitoring fringe banks is explained by differences in the economic and political power of their customers.” *Id.*

⁶⁴ See, e.g., John P. Caskey, *Checking-Cashing Outlets in a Changing Financial System* 2 n.1 (Fed. Res. Bank of Phila., Working Paper No. 02–4, 2002), <http://www.phil.frb.org/files/wps/2002/wp02–4.pdf>.

⁶⁵ This ruse is often referred to as “Rent-a-Bank” or “Rent-a-Charter.” The Supreme Court upheld the legality of this scheme in *Beneficial Nat’l Bank v. Anderson*, 539 U.S. 1, 9–11 (2003). See also Barr, *supra* note 7, at 148 n.105 (“The OCC’s position on non-interest charges is functionally similar to a national bank’s authority to ‘export’ the interest rate permissible for the national bank to charge in its home location to the state where it is making the loan.” (citing 12 C.F.R. § 7.4001 (2004) and *Marquette Nat’l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978)); Chin, *supra* note 62, at 732 (arguing that Congress should enact federal law prohibiting this scheme). The OCC has taken a similar federal preemption position against states’ anti-predatory lending laws. See Nicholas Bagley, Note, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274, 2274–75 (2004).

Moreover, non-preempted state laws that regulate the number of check cashers that may operate in a given area have shown to actually stifle competition, thereby increasing fees for CCO’s customers. See Barr, *supra* note 7, at 148. For examples of state laws restricting areas in which check cashiers may operate, see, e.g., N.J. STAT. ANN. § 17.15a–41e (West 2001); N.Y. BANKING LAW § 369 (McKinney Supp. 2005).

⁶⁶ CASKEY, *supra* note 38, at 6; see generally DAVID CAPLOVITZ, *THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES* (1963) (discussing consumption practices and obstacles for low-income consumers).

⁶⁷ See CASKEY, *supra* note 38, at 2.

unbanked. Moreover, since the unbanked are less likely to have a credit card that can be used to smooth out hard times—even though they are more likely to fall on hard times—unbanked consumers often resort to pawnshops for short-term credit. However, unlike loans made through conventional banks, a pawnshop customer will typically pay at least a 240% annual percentage rate (APR) for a mere fifty dollar loan.⁶⁸ Likewise, consumers who take out payday loans can expect to pay a remarkable 470% APR on that loan.⁶⁹ Though a seamless comparison between conventional banks and check-cashing outlets is not entirely feasible, it is evident that financial services from banks are more affordable than those from CCOs.⁷⁰

An often overlooked but extremely real cost of employing CCOs is “impulse spending.” Impulse spending is the natural spending behavior that many consumers exhibit after physically receiving a lump sum of money. In simple terms, it is tempting to spend money that is burning a hole in your pocket. CCOs know this, and they tend to offer “impulse products,” such as lottery tickets, cigarettes, candy, and jewelry, to take advantage of impulse spending.⁷¹ This sort of natural spending behavior coupled with such a marketing scheme further frustrates the unbanked consumer’s capacity to accumulate savings.

C. Legislative Attempts to Bank the Unbanked

Acknowledging that “[a]ccess to the payments system is not a luxury,” but rather “a necessity of modern life,”⁷² federal and state

⁶⁸ See *id.* at 39 (describing rates in states where pawnshop fees are unregulated or loosely restricted).

⁶⁹ See Barr, *supra* note 7, at 154.

⁷⁰ See CASKEY, *supra* note 38, at 65. Some justify the high cost of check-cashing outlets by citing the risks involved in their line of business. Even still, many, if not most, CCOs only cash government or payroll checks, which are low-risk transactions, and refuse personal checks. See *id.* at 55. Surprisingly,

[b]anks in urban areas generally refuse to cash checks drawn on other banks for nondepositors, even government checks with negligible default risk. Banks will cash checks for depositors, but most banks require the customer either to maintain sufficient funds in an account to cover the check or to wait a few days for the check to clear.

Id. at 61 (footnote omitted).

⁷¹ *Id.* at 56.

⁷² *Banking Services in Low- and Moderate-Income Communities: A Two-Tiered Services System?: Hearing Before the Subcomm. on Consumer Credit and Insurance of the H. Comm. on Banking, Finance and Urban Affairs*, 103d Cong. 86 (1995) (statement of Deepak Bhorgova, Legislative Director, Association of Community Organizations for Reform NOW (ACRON)).

legislatures have taken notable measures to bank the unbanked.⁷³ However, government also has acknowledged that it cannot accomplish this socially desirable aspiration without cooperation from mainstream financial institutions. As Professor Vincent Di Lorenzo puts it, “Experience has taught us that government alone, or government efforts to supplement private markets, cannot substantially achieve many embraced social outcomes—e.g., economic development in low-income communities. Instead, the decisions of corporate citizens control such outcomes, through control over the resources needed for substantial progress.”⁷⁴

This Section briefly outlines government measures to induce the private sector to serve the unbanked market. By way of preview, this Section simply demonstrates that there is a strong governmental push to ensure that every financially responsible individual, particularly those from low-income communities, has access to a bank account.

1. State Initiatives—Lifeline Bank Accounts

Since the 1990s, a handful of states have explored options to offer basic banking services through so-called “lifeline accounts.”⁷⁵ Lifeline accounts are low- or no-cost bank accounts in which legislation rather than the bank sets the account’s terms.⁷⁶ However, despite the fact that several state laws require banks to offer low-cost accounts, most banks neglect to market this service to low-income populations, thereby substantially weakening these state initiatives.⁷⁷

2. Federal Initiatives

Congress has likewise debated and enacted legislation to bank the unbanked. Currently, Congress is debating several bills that aim

⁷³ Extending access to bank accounts is not simply a domestic goal. Foreign governments have also taken measures to secure access to bank accounts. See generally KEMPSON ET AL., *supra* note 18, at 1 (discussing “widespread and mounting concern about access to banking services across most developed nations—in Europe and North America as well as Australasia”).

⁷⁴ Vincent M. Di Lorenzo, *Equal Economic Opportunity: Corporate Social Responsibility in the New Millennium*, 71 U. COLO. L. REV. 51, 54 (2000).

⁷⁵ See generally Edward L. Rubin, *The Lifeline Banking Controversy: Putting Deregulation to Work for the Low-Income Consumer*, 67 IND. L.J. 213 (1992) (discussing history and efficiency of lifeline banking accounts).

⁷⁶ See Joseph J. Doyle et al., *How Effective is Lifeline Banking in Assisting the ‘Unbanked’?*, CURRENT ISSUES IN ECON. & FIN., June 1998, available at 1, http://www.cfsinnovation.com/managed_documents/ny_fed_june_1998.pdf.

⁷⁷ See Belsky & Calder, *supra* note 27, at 24 (noting connection between lack of promotion and low-income consumers’ failure to utilize products); Doyle, *supra* note 76, at 2. In an effort to fill the gap left by mainstream financial institutions, subprime and predatory lenders aggressively market to this population.

to move unbanked consumers to mainstream banks,⁷⁸ and has considered lifeline-account legislation in the past.⁷⁹ One promising avenue that the federal government has pursued has been to employ electronic banking as a way of banking the unbanked.⁸⁰ This Section briefly outlines the most important of these initiatives.

a. Electronic Transfer Accounts

Created pursuant to the Debt Collection Improvement Act of 1996,⁸¹ the Electronic Transfer Accounts (ETAs) program⁸² is a principal illustration of the federal government's efforts to bank the unbanked. Similar to states' lifeline accounts, ETAs are no-frills, low-cost accounts issued to unbanked federal beneficiaries through federally insured banks. Banks are permitted to participate in the program on a voluntary basis.⁸³ To offset costs, the Treasury Department compensates participating banks with a one-time payment for each ETA account opened.⁸⁴ The reasons underlying this uniform transformation are two-fold: (1) to improve cost efficiency in distributing government benefits via direct deposit instead of paper checks;⁸⁵ and (2) to encourage welfare recipients—a group where an estimated three out of four are unbanked⁸⁶—to move to mainstream banking.⁸⁷ Thus

⁷⁸ See, e.g., H.R. REP. NO. 109-38 (2005) (reporting on amendment “to permit federal credit unions to offer check-cashing and money transfer services to non-members of the credit union”); H.R. Res. 148, 109th Cong. (2005) (“[s]upporting the goals and ideals of Financial Literacy Month”); S. Res. 88, 109th Cong. (2005) (“[d]esignating April 2005 as ‘Financial Literacy Month’”); H.R. Res. 894, 109th Cong. (2005) (detailing bill “to protect taxpayers from unscrupulous refund anticipation loan providers”).

⁷⁹ See generally *Government Check Cashing, “Lifeline” Checking, and the Community Reinvestment Act: Hearing on S. 906, S. 907, and S. 909 Before the Subcomm. on Consumer & Regulatory Affairs of the S. Comm. on Banking, Housing, & Urban Affairs*, 101st Cong. (1989); *Ways of Increasing Access of Low- and Moderate-Income Americans to Financial Services: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation & Deposit Insurance and Subcomm. on Consumer Credit & Insurance of the Comm. on Banking, Finance & Urban Affairs*, 103d Cong. (1994).

⁸⁰ See generally STEGMAN, *supra* note 30 (discussing impact of electronic fund transfers on unbanked).

⁸¹ 31 U.S.C. § 3332 (Law Co-op. Supp. 2000).

⁸² 31 C.F.R. pt. 208 (1999).

⁸³ See *id.* § 208.5.

⁸⁴ See Notice of Electronic Transfer Account Features, 64 Fed. Reg. 38,510, 38,510 (July 16, 1999).

⁸⁵ STEGMAN, *supra* note 30, at 5.

⁸⁶ See *id.* at 8.

⁸⁷ See *id.* at 14-37 (discussing impetus for ETA).

far, the ETA program has shown modest success,⁸⁸ but improvements have been suggested.⁸⁹

b. Electronic Benefits Transfer Act

Similarly, as part of the Welfare Reform Act,⁹⁰ Congress has pressed states to issue federal benefits electronically under the Electronic Benefits Transfer Act (EBT).⁹¹ To date, the initiative has been overwhelmingly successful at eliminating paper food stamps.⁹² However, under the Act, states are not required to issue benefits through banks, thus “minimiz[ing] the extent to which electronic transfer could be utilized as an entry point to banking.”⁹³ Instead, with the purpose of collecting interest on the float of these funds, many states contract with the private sector “to provide debit-based access to funds held by the state government in a pooled account.”⁹⁴ These debit-based accounts neither provide the security nor the interest-bearing savings features of conventional bank accounts, since recipients “do not actually own the accounts they are accessing.”⁹⁵ Though the current structure of EBT accounts is unlikely to move a significant number of unbanked consumers to mainstream banks, the EBT program could be reformed to achieve this goal.⁹⁶

c. First Accounts

Many of the unbanked do not receive, or are ineligible to receive, federal benefits. Accordingly, ETAs and EBT are unlikely to move this population to mainstream banks. To reach this unbanked population, the federal government has piloted another initiative: the First Accounts Program.⁹⁷ Implemented through the Treasury Depart-

⁸⁸ See GAO REPORT, *supra* note 14, at 25–26 (“[S]ince the program was initiated in July 1999, about 36,000, or fewer than 1 percent, of unbanked federal beneficiaries had opened ETAs by June 2002. Most financial institutions do not offer them. Because some of the nation’s biggest banks, which typically have the greatest number of branches, have enrolled in the ETA program, opportunities to reach ETA prospects have increased. But these banks often market the ETA only on a limited basis, as they do not see the account as profitable.”).

⁸⁹ See Barr, *supra* note 7, at 186 (suggesting that ETA could be improved through greater marketing efforts and education).

⁹⁰ 7 U.S.C. § 2016(i) (2000).

⁹¹ 7 C.F.R. pt. 274 (1999).

⁹² See Barr, *supra* note 7, at 188 (noting that 80% of food stamps are issued through EBT accounts).

⁹³ See *id.* at 189.

⁹⁴ See *id.*

⁹⁵ STEGMAN, *supra* note 30, at 114.

⁹⁶ See *id.* at 190 (suggesting that states negotiate with banks to provide low-cost access to accounts under EBT program).

⁹⁷ Notice of Funds Availability, 66 Fed. Reg. 66,975 (Dep’t of Treasury Dec. 27, 2001).

ment, the Program provides funds to private organizations that seek to expand affordable financial resources to the unbanked, provide financial education and counseling to the unbanked, or research the needs of this population.⁹⁸ To date, First Accounts has provided over \$8 million to grantees, who are attempting to target over 35,000 unbanked consumers.⁹⁹ Since the Program is quite new, no useful data exists on its successes or failures.

For our purposes, however, one thing is evident: All of these initiatives demonstrate government's strong desire to move unbanked consumers into the mainstream banking economy. As Part II and III show, ChexSystems frustrates these efforts.

II

CHEXSYSTEMS: AN UNVEILING

To be effective, government efforts to bank the unbanked must parallel efforts to eliminate unwarranted exclusions from mainstream banks. Legislatures must therefore take account of the banking industry's ability to undercut this governmental imperative. With this in mind, this Section unveils the workings of the ChexSystems database.

Most American consumers are aware that credit bureaus maintain records of their credit history. Yet most consumers have little to no knowledge that a select few of these credit bureaus collect and maintain records on their checking account histories.¹⁰⁰ As one reporter noted, "Even though [ChexSystems's] practices have spawned a Web-based subculture of horror stories, tell-all websites, and vocal opponents, the average American still doesn't know anything about it, or how severely it can affect your life."¹⁰¹

ChexSystems, a subsidiary of eFunds, Inc., is the largest specialized credit bureau that collects and maintains information on consumers' checking account activity. Founded in 1971, 80% of U.S. banks, including all of the major banks, employ ChexSystems by processing new checking account applicants' social security numbers through the database prior to opening new checking accounts.¹⁰²

⁹⁸ DEPT. OF THE TREASURY, FIRST ACCOUNTS PROGRAM: SUMMARY OF GRANT AWARDS, <http://www.treas.gov/offices/domestic-finance/financial-institution/fin-education/firstaccounts/grantssummary.html> (last visited May 29, 2005).

⁹⁹ See *id.*

¹⁰⁰ See Bosworth, *supra* note 3; Beckett, *supra* note 1 (stipulating that 80% of bank branches in the country subscribe to ChexSystems' national database); Powell, *supra* note 16; see *supra* note 3.

¹⁰¹ Bosworth, *supra* note 3.

¹⁰² See Beckett, *supra* note 1; eFUNDS, *supra* note 16, at 3 (reporting that 8500 financial institutions subscribe to ChexSystems network).

Some banks have also employed ChexSystems prior to approving loan applications,¹⁰³ credit card applications,¹⁰⁴ and savings account applications.¹⁰⁵ Like most credit reporting agencies, banks employ ChexSystems to screen for fraudulent or financially risky consumers.

If an applicant's name appears in the database, participating banks have the option to—and almost certainly will¹⁰⁶—deny that applicant a checking account.¹⁰⁷ Similarly, if a consumer has two separate accounts with two separate banks, each bank has the option to close the accountholder's respective account if the accountholder is reported to ChexSystems by either the home bank or the other bank.¹⁰⁸ Moreover, ChexSystems maintains adverse information on consumers for five years, which, for all practical purposes, means that consumers appearing in the database will be unsuccessful in opening or maintaining an existing checking account at 80% of U.S. banks for a five-year period.¹⁰⁹

ChexSystems obtains adverse information on a consumer's checking account history from banks that have subscribed to the network ("member banks"). Member banks voluntarily furnish adverse information on their accountholders to ChexSystems if an

¹⁰³ See, e.g., *Kelly v. Bank Midwest*, 177 F. Supp. 2d 1190, 1195 (D. Kan. 2001) (denying loan application partly based on ChexSystems record).

¹⁰⁴ Connery, *supra* note 16, at 11.

¹⁰⁵ ChexSystems Bites website, <http://members.tripod.com/chexsys/hallofshame.html> (last visited August 3, 2005) (reporting on BankOne). ChexSystems Bites is a consumer advocacy website dedicated to exposing ChexSystems abuses.

¹⁰⁶ See Beckett, *supra* note 1 ("[I]f you are in the system, a checking account is not an option . . ."); Beckett, *supra* note 4 (referring to "practice of many banks of refusing to open a checking account for anyone whose name appears in ChexSystems"); Connery, *supra* note 16, at 12 (discussing criticisms of ChexSystems, including that some customers have been "locked out" of banking system); Powell, *supra* note 16 (referring to customers being "blacklisted" based on ChexSystems record).

¹⁰⁷ In the ETA context, a bank that chooses to offer ETA accounts may not, pursuant to a contractual agreement between the bank and the Federal Reserve, deny an ETA applicant an ETA account solely because that applicant's name appears in ChexSystems, except in cases where reporting was due to suspected fraud on an ETA account or where reporting was due to misuse of an ETA account at that particular bank. See Notice of Electronic Transfer Account Features, 64 Fed. Reg. 38,510, 38,512, app. at 38,517 (July 16, 1999) [hereinafter Financial Agency Agreement]. Yet, it should be noted, banks are not required to offer ETA accounts at all, see 31 C.F.R. § 208.5 (1999), and most banks do not, see *supra* note 88 (discussing limited success of ETA program).

¹⁰⁸ See Beckett, *supra* note 1; Quinn, *supra* note 23 (noting option of banks to close checking accounts of customers reported to ChexSystems). For banks that voluntarily offer ETA accounts, they are permitted to close an ETA account for fraud or misuse just as they may close any other account. See Financial Agency Agreement, *supra* note 107, at 38,518.

¹⁰⁹ See, e.g., Beckett, *supra* note 1.

accountholder has been deemed to have prior “problems” with their checking accounts.¹¹⁰

As a credit bureau, however, ChexSystems does not determine what constitutes a “problem.”¹¹¹ Instead, in determining which checking accounts are “problems,” the member bank has *carte blanche*.¹¹² Consequently, the “problems” that many banks report vary from suspected fraud to a single overdraft (or “bounced check”).¹¹³ Banks do not, nor are they required to, report account-holders’ *favorable* checking account history to ChexSystems.¹¹⁴

Pursuant to this wide discretion, ChexSystems reporting policies differ from bank to bank—and, in some cases, from branch to branch.¹¹⁵ Where reporting policies vary among each branch, total discretion rests with the branch’s manager.¹¹⁶ This discretion naturally has produced considerable variation in the industry: One bank

¹¹⁰ See Connery, *supra* note 16; Beckett, *supra* note 1

¹¹¹ eFunds, ChexSystems’ parent company, explains:

The ChexSystems Financial Institution Closure and Collection Reporting Data Contribution Policy allows for a common understanding between all participating institutions as to what data is contributed to the database and how such contribution will be governed. Highlights of the policy include:

[Member Bank] Responsibilities:

- Contribute suspected fraud and forcible closures meeting policy requirements ensuring data is accurate and complete.
- Report forcible closures immediately after charge-off (when accuracy has been confirmed) – ideally within 10 days after date of charge off. All closures should be reported within 75 days of the initial overdraft date.
- Distinguish between account abused and suspected fraudulent activity through the use of reason codes.
- Report paid-in-full/settled-in-full (PIF/SIF) date as a change to previously reported closure information.
- Report total charge-off dollar amount with each closure.
- Delete only those records reported in error. PIF/SIF closures should be updated, not deleted.

ChexSystems Responsibilities:

- Post reported closure and collections date to ChexSystems databases within 24 hours of receipt.
- Report compliance metrics to financial institutions to facilitate policy enforcement.
- Enforce the policy with [participating banks].

eFUNDS, INC., eFUNDS AND DATA PRIVACY: DATA PRACTICES FOR THE RISK MANAGEMENT LINE OF BUSINESS 2 (2003) [hereinafter eFUNDS AND DATA PRIVACY], http://www.efunds.com/us/en/about_efunds/whitepapers/000950.pdf (last visited May 29, 2005).

¹¹² See, e.g., Beckett, *supra* note 1 (noting that policies for deciding when to close accounts are entirely based in banks’ discretion).

¹¹³ See, e.g., *id.*; Bosworth, *supra* note 3 (“The definition of [“problem”] varies tremendously according to banks’ individual policies . . .”).

¹¹⁴ See eFUNDS AND DATA PRIVACY, *supra* note 111, at 2. ChexSystems does require banks to report the date when an account becomes paid-in-full/settled-in-full. See *id.*

¹¹⁵ See, e.g., Beckett, *supra* note 1; NCRC REPORT, *supra* note 20.

¹¹⁶ NCRC REPORT, *supra* note 20.

may report accounts that exceed several \$100 overdrafts, while another bank may report accounts that exceed only a *single \$35 overdraft*.¹¹⁷ Similarly, some member banks may wait two months before reporting a deficit account to ChexSystems, while others may wait only a couple of weeks.¹¹⁸ This alone is alarming, but, as the next Part discusses, some banks may employ ChexSystems to discriminate against certain consumers.

III CHEXSYSTEMS: RISK MANAGEMENT OR DISENFRANCHISEMENT?

Every financially responsible consumer should have the right to access a bank account. ChexSystems's defenders argue that ChexSystems allows banks and retail stores to avoid financial loss by identifying risky, irresponsible, or fraudulent consumers.¹¹⁹ This is certainly a notable consideration. However, considering the financial exile and hardship that former accountholders are subjected to, it is important from a policy perspective to ensure that consumers are not unfairly or unnecessarily segregated from the mainstream financial economy through the banking industry's use of ChexSystems.

This Section suggests that ChexSystems, in its current form and application, may be doing exactly that: unnecessarily disenfranchising millions of consumers from the mainstream banking economy. First, the industry may be overinclusive in reporting certain consumers to ChexSystems in that (1) a ChexSystems report may serve—or, at the very least, could serve—as a camouflage for discriminatory behavior; and (2) financial institutions fail to consider social costs prior to closing and reporting accounts. Secondly, the mere existence of a ChexSystems report will more than likely cause a consumer to be denied a checking account. This over-reliance on ChexSystems reports undoubtedly results in situations where banks deny accounts to consumers who are capable of responsibly maintaining a checking

¹¹⁷ See *supra* note 20 and accompanying text; Quinn, *supra* note 23 (reporting that “[a]n ex-employee of ChexSystems [stated that] she saw [reported] accounts that were overdrawn by just \$1.97”).

¹¹⁸ Bank of America writes a letter to delinquent accountholders stating, “If we do not hear from you within 10 days we will send a report to Chex Systems Inc., an account (sic) verification service. We will also turn matter over (sic) to a collection agency to help us recover the funds.” See *Miller v. Bank of America*, 2004 WL 2403580, ¶ 53 (Cal. App. Dep’t Super. Ct., Oct. 13, 2004). One could imagine that, since no regulatory scheme is in place, a bank may decide to report accounts that are delinquent by one dollar extending over a single week.

¹¹⁹ See Beckett, *supra* note 1 (noting that ChexSystems website reads, “Who wants a risky customer? Certainly you don’t. And no one else does either.”).

account. Even for those consumers who are in fact “risky,” the banking industry’s universal rejection of any consumer who appears in the database for a five-year period, without considering other pertinent factors, often imposes disproportionate penalties for past mistakes. For those consumers who should not be classified as “risky” at all—say, those who bounced a single \$35 check—the penalties are that much more harsh and excessive.

A. *Banks’ ChexSystems Procedures are Overinclusive*

As explained, every banking institution creates its own set of procedures for reporting accounts to ChexSystems, as well as its own set of procedures for opening new accounts. From an economist’s perspective, given that they are profit-driven institutions, banks will presumably only report accountholders that are deemed genuinely “risky,” either through repeated financial mismanagement of their accounts or through fraudulent activity. As one commentator legitimately asks, “Why [would banks] lock so much potential profit out of the system?”¹²⁰ In practice, however, banks may tend to err on the side of “safety” when dealing with lower tier accountholders¹²¹—thus leading to grotesque overinclusiveness in two ways.

1. *ChexSystems: A Pretext for Racial Discrimination?*

ChexSystems’s critics have charged that, given their wide discretion, banks have been more willing to report checking accounts held by lower tier consumers than their better-heeled counterparts.¹²² Further still, given that a segment of lower tier consumers are members of minority groups,¹²³ it is quite possible that banks may discriminatorily report minority consumers to ChexSystems while ignoring equally situated white consumers’ ChexSystems files, and may justify these decisions with “legitimate business reasons.” Though no authoritative

¹²⁰ Bosworth, *supra* note 3. *But see* Beckett, *supra* note 1 (suggesting that “[t]he answer lies in what kind of client financial institutions are pursuing for membership”); Janet Dean Gertz, *The Purloined Personality: Consumer Profiling in Financial Services*, 39 SAN DIEGO L. REV. 943, 960 (2002) (“Statistics show that eighty percent of a bank’s profit is gained from only twenty percent of their customers.”); Barr, *supra* note 7, at 183 (suggesting that banks perceive low-income consumers as unprofitable).

¹²¹ See *supra* Part I (discussing banks’ treatment of unprofitable and less profitable customers); *supra* notes 155-158 and accompanying text.

¹²² See Bosworth, *supra* note 3; Beckett, *supra* note 1 (“[T]he inflexibility of the database’s five-year term and the way most banks employ it appear to take an especially heavy toll in low-income areas.”); Quinn, *supra* note 23. After the Watts Division of the NAACP solicited calls from people who had problems with ChexSystems, it received over 2500 phone calls within a one-week period. See Beckett, *supra* note 1.

¹²³ See generally CASKEY, *supra* note 38 (describing characteristics of fringe banking customers).

proof demonstrates that banks have discriminated against minority consumers in this way,¹²⁴ it certainly would not be the first time that the banking industry has allowed prejudice to impede its relationships with minority consumers.¹²⁵

The assertion that banks employ ChexSystems as an unwarranted exclusionary tool is bold, but such behavior would not be without precedent. Banks have historically avoided serving minority populations,¹²⁶ and such historical treatment may tell us something about how banks may be currently employing ChexSystems. By way of comparison, studies in fair lending scholarship have extensively documented ways in which the banking industry has denied loans to creditworthy minority consumers.¹²⁷ For instance, redlining—the practice of making lending decisions rooted in “generalized stereotypes associated with a specific neighborhood” or race¹²⁸—has been found to impede low-income minority communities’ opportunities to secure loans or investments.¹²⁹ As recently noted, “[M]any banks do not even maintain branches in minority neighborhoods.”¹³⁰

An additional indication that banks may practice discrimination in reporting minority accountholders to ChexSystems can be taken from other studies conducted in the area of fair lending. The statis-

¹²⁴ The public’s ignorance of ChexSystems partly explains this lack of evidence. Even if a study were conducted to test the validity of this claim, banks generally have no incentive, nor would they necessarily be required, to provide this information; moreover, they may not have collected or maintained such information themselves. In any case, researchers have noted “the enormous methodological problems associated with assembling data to determine whether either intentional or ‘disparate-impacts’ discrimination is occurring in U.S. lending institutions.” John Goering & Ron Wienk, *An Overview, in MORTGAGE LENDING, RACIAL DISCRIMINATION, AND FEDERAL POLICY* 3, 6 (John Goering & Ron Wienk eds., 1996) [hereinafter *MORTGAGE LENDING*].

¹²⁵ See, e.g., Barr, *supra* note 7, at 183 (noting that banks’ perceptions of low-income consumers are barriers to banking poor).

¹²⁶ See, e.g., John P. Caskey, *Bank Representation in Low-Income and Minority Urban Communities*, 29 *URB. AFF. Q.* 617, 618 (1994); *infra* note 130 and accompanying text.

¹²⁷ See, e.g., Alicia H. Munnell et al., *Mortgage Lending in Boston: Interpreting HMDA Data* (Fed. Reserve of Boston, Working Paper No. 92–07, 1992), available at http://www.bos.frb.org/economic/wp/wp1992/wp92_7.pdf (finding that minorities were nearly sixty percent more likely to be rejected for loans). See generally Helen F. Ladd, *Evidence on Discrimination in Mortgage Lending*, *J. ECON. PERSP.*, Spring 1998, at 41 (1998) (exploring data demonstrating existence of discrimination in mortgage lending); *MORTGAGE LENDING*, *supra* note 124 (compiling studies of discrimination in mortgage lending); *MORTGAGE LENDING DISCRIMINATION: A REVIEW OF EXISTING EVIDENCE 2* (Margery Austin Turner & Felicity Skidmore, eds. 1999), available at <http://www.urban.org/urlprint.cfm?ID=6407> (finding evidence of discrimination in review of mortgage lending research).

¹²⁸ Maree, *supra* note 31, at 800.

¹²⁹ See generally *MORTGAGE LENDING*, *supra* note 124 (compiling articles studying impact of racial stereotyping on credit and mortgage markets).

¹³⁰ DEANNE LOONIN & CHI CHI WU, *NAT’L CONSUMER LAW CTR., CREDIT DISCRIMINATION* § 1.1.1 (3d ed. 2002).

tical discrimination theory, in particular, suggests that banks may lump all minority consumers together and write those groups off as “financially irresponsible” simply because the group as a whole has a higher chance of default. In doing so, the theory is that banks fail to consider the individual chances of default among each consumer in the group.¹³¹

It is important to understand that this sort of discrimination is rooted in a bank’s desire to maximize profit, not bigoted discrimination. But, regardless of its source, this profit-maximizing behavior is nonetheless hurtful and unlawful discrimination,¹³² but extremely difficult to prove. If the statistical discrimination theory is in fact valid,¹³³ such discrimination may not only take place in banks’ lending decisions, but also in banks’ decisions to open or close checking accounts.

Finally, fair lending studies have found that the “personal prejudice of individual decision-makers may lead them to discriminate” against selected applicants.¹³⁴ Since the decision of whether to open, close, or report an account to ChexSystems is at times delegated to individual branch managers,¹³⁵ these branch managers’ personal prejudices or stereotypes of low-income or minority applicants may very well play into their decisions.¹³⁶

¹³¹ See John Yinger, *Discrimination in Mortgage Lending: A Literature Review*, in MORTGAGE LENDING *supra* note 124, at 29, 52–53; see also Keith N. Hylton & Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and The Community Reinvestment Act*, 85 GEO. L.J. 237, 247–50 (1996). For the relationship between predictions and self-autonomy, see Barbara D. Underwood, *Law and the Crystal Ball: Predicting Behavior with Statistical Inference and Individual Judgment*, 88 YALE L.J. 1408, 1414 (1979) (“The attempt to predict an individual’s behavior seems to reduce him to a predictable object rather than treating him as an autonomous person.”).

¹³² See *infra* Part IV.B (discussing Equal Credit Opportunity Act); Anthony D. Taibi, *Banking, Finance, and Community Economic Empowerment: Structural Economic Theory, Procedural Civil Rights, and Substantive Racial Justice*, 107 HARV. L. REV. 1463, 1481 (1994) (noting that “fully ‘rationalized’ settings . . . may permit worse forms of institutional racism”).

¹³³ See Yinger, *supra* note 131, at 52 (suggesting that no direct evidence exists that banks practice statistical discrimination in lending decisions).

¹³⁴ *Id.* at 53.

¹³⁵ See Beckett, *supra* note 1; NCRC REPORT, *supra* note 20, at 14; NCIF REPORT, *supra* note 20, at 3.

¹³⁶ See Taibi, *supra* note 132, at 1479 (“Rather than reflecting actual ability and willingness to repay debts, particular qualifications are in fact only indicia associated with, but not determinative of, what succeeded in a creditor’s past—a past that was typically ‘White only.’”); *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026, 1030 (N.D. Ga. 1980) (acknowledging that “a given creditor could operate under the notion that a particular class of persons protected under the [ECOA], are, for whatever reason, less reliable or creditworthy than others and may consciously or subconsciously select criteria which will have a tendency to ‘screen out’ applicants in that class.”).

In lending decisions, Professor Yinger identifies five specific steps where banks—either in an institutional or representative capacity—have an opportunity to discriminate against applicants:

The first step is advertising and outreach. To some extent, lenders use traditional means to advertise loans, such as newspapers and television, but they also advertise by posting signs in their windows. Thus, the location of their offices is an important element of their advertising programs. Some lenders also may make special efforts to reach certain segments of the population in their market area. The second step involves the lender's application procedures. How are people treated when they enter the lender's office to inquire about a loan? Do application procedures discourage minority applicants? The third step is loan acceptance. . . . The fourth step, which occurs simultaneously with the third, is the determination of loan terms. . . . The fifth step is loan administration. . . . [L]enders may be more likely to initiate foreclosure procedures with minority borrowers in default than with comparable white borrowers.¹³⁷

Notably, the five steps that Yinger identifies as opportunities for lending discrimination could equally pertain to banks' decisions to extend checking accounts.

By way of illustration, in *Kelly v. Bank Midwest*,¹³⁸ bank employees, after calling the police on a suspicion of fraud as well as an uncomfortable "gut feeling,"¹³⁹ advised an African-American male loan applicant, Willie Kelly, that "because of [his] ChexSystems report [which showed *one* bounced check] and pursuant to the bank's policy, [the bank] could not complete his transaction . . . [and] that he would need to get the ChexSystems matter straightened out before the bank could proceed with his loan application."¹⁴⁰ The bank employees cited no reason other than Willie's ChexSystems file as a barrier to reviewing his loan application. A few days later, when Willie's brother, Dederick Kelly, applied at the same bank for a loan, a bank employee stated that Willie's ChexSystems report made her "feel uncomfortable,"¹⁴¹ despite the fact that Dederick and Willie were "two separate people."¹⁴² Without hesitation and after an extensive review of other facts that signaled discriminatory behavior, the court

¹³⁷ Yinger, *supra* note 131, at 54–55.

¹³⁸ 177 F. Supp. 2d 1190 (2001).

¹³⁹ *Id.* at 1198.

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 1200.

¹⁴² *Id.* at 1201.

held that it was clear that the bank employees “intentionally discriminated against [Dederick] on the basis of race.”¹⁴³

Kelly would seem to confirm a suspicion about how some banks are using ChexSystems. Specifically, the *Kelly* case suggests that at least some banks use ChexSystems as a pretext to discriminate against minority loan applicants. Otherwise, it would seem that no justifiable reason could possibly have existed as to why Willie’s ChexSystems file would make the bank “feel uncomfortable” about Dederick’s loan application. Furthermore, the facts clearly demonstrate that the bank employees harbored “suspicion” about the Kellys *prior* to running the Kellys through the ChexSystems database. Rather than admit that they harbored suspicion on the basis of the Kellys’ race, the bank employees used—at least initially—Willie’s ChexSystems file as a ploy to deny *both* of the Kellys’ loan applications.¹⁴⁴ This sort of institutional behavior lends credence to the idea that banks have used ChexSystems in an invidious manner.¹⁴⁵

Responding to cases like *Kelly*, legislatures have enacted an array of regulations to combat unwarranted and socially harmful evasions in lending.¹⁴⁶ However, legislative efforts to combat discrimination in lending have failed to recognize how such discrimination may in fact spill over into other banking services, namely the provision of checking accounts.

Though the evidence is largely inferential, legislatures should nonetheless care about the bona fide risk that the banking industry’s

¹⁴³ *Id.* at 1208. Absent other facts that clearly pointed to the employees’ discriminatory behavior, it would be unlikely that the court would have found that the employees were discriminating based solely on the employees’ reliance on Willie’s ChexSystems file. In other words, where employees in fact employ ChexSystems as a pretext for discrimination and where no other facts point to discrimination, it would be unlikely that a court would make a finding of intentional discrimination.

¹⁴⁴ For a definitive answer to the question of whether the bank employees were discriminating against the Kellys, we would need to know whether, in the absence of Willie’s ChexSystems file, the bank would have serviced the Kellys’ applications. On the facts, this seems highly unlikely.

¹⁴⁵ Although the bank in this case rejected the Kellys’ *loan* applications, it seems likely that the Kellys would not have been able to get *checking accounts* from this particular branch either. The ChexSystems database, after all, contains better information with respect to checking accounts than it does with respect to loans. Even though the bank would have had an apparently “legitimate business reason” for denying Willie’s application for a deposit account, the bank’s “legitimate business reason” must now be questioned because the facts show that the bank employees harbored prejudices about the Kellys from the very beginning, independent of the existence of a “legitimate business reason.” Put simply, the bank’s actual justification (i.e., discrimination) for denying the Kellys’ applications for deposit accounts would be perpetually concealed by the bank’s pretextual reliance on Willie’s ChexSystems file. This Note suggests that this very scenario may be currently materializing in the banking industry.

¹⁴⁶ See *infra* Part IV.

use of ChexSystems could simply be another means to exclude historically “unwanted” consumers from its clientele. Given that many banks are currently establishing or partnering with the profitable fringe banking industry,¹⁴⁷ the incentives of mainstream banks to “blacklist” certain accountholders is stronger than ever. Therefore, when a bank justifies its rejection of a checking account applicant by referring to a ChexSystems report, “such [justification] should be subjected to scrutiny to see if [it is] really necessary to meet legitimate business objectives, namely, accurately predicting creditworthiness.”¹⁴⁸

2. *Evaluating Creditworthiness and Social Costs in Closing and Reporting Accounts*

Leaving aside the question of discrimination for the moment, some banks, nevertheless, opt to close and report accounts to ChexSystems for quite modest overdraft amounts. This casts doubt on one of the central justifications that banks provide for blacklisting consumers: namely, that ChexSystems aids banks in making an assessment of an accountholder’s ability to handle a checking account. One major bank, for example, closes and reports accounts with overdrafts of more than \$25 extending over a 45-day period.¹⁴⁹ Others only wait 30 days.¹⁵⁰ Essentially, this means that an otherwise financially responsible accountholder could be blacklisted from all mainstream financial institutions for five years on the basis of a mere \$25 overdraft. At least “theoretically,” a bank could even report an accountholder for a one dollar delinquent account extending over a one-week period. In a profit-motivated industry, this unchecked discretion is naturally ripe for abuse.¹⁵¹

It has been argued that banks should be permitted to determine a consumer’s creditworthiness in accordance with their own individual internal procedures and business-risk models, even if those models have a disparate impact on lower-income or minority accountholders.

¹⁴⁷ See *supra* note 60 and accompanying text.

¹⁴⁸ *Cherry v. Amoco*, 490 F. Supp. 1026, 1030 (N.D. Ga. 1980). The facts surrounding *Cherry* involved alleged credit card discrimination, not discrimination involving checking accounts or ChexSystems; nonetheless, the standard that the Court provided is equally applicable for our purposes. See *supra* Part IV.C (employing aforementioned standard under CRA examinations).

¹⁴⁹ See Beckett, *supra* note 1. While ChexSystems representatives contend that ChexSystems “isn’t aimed at punishing those who simply bounce a couple of checks,” they admit that “it’s entirely up to banks to determine how to use the database.” See *id.*

¹⁵⁰ See NCRC REPORT, *supra* note 20, at 4.

¹⁵¹ In practice, there are indications that banks have abused this discretion. See generally, Beckett, *supra* note 1; NCRC REPORT, *supra* note 20; NCIF REPORT, *supra* note 20.

After all, one might reason, since other creditors, such as credit card companies, are capable of evaluating a consumer's ability to handle a credit account prior to closing and reporting the account to a credit reporting agency, so too should banks be permitted to evaluate a consumer's riskiness without regard to any external regulatory constraints. As discussed below, however, this argument gives little weight to two notable considerations.

a. Banks' Social Decision-Making Power

First, banks play an important social function that legislatures have sought to regulate and courts have long recognized,¹⁵² making them akin to quasi-public entities.¹⁵³ Having quasi-public status necessitates that these private institutions consider the social costs of their private decisions.¹⁵⁴ As suggested above, in the context of bank accounts, society in general, and low-income communities in particular,¹⁵⁵ incur numerous costs when a financial institution unjustifiably excludes a consumer from opening a bank account. Banks have no incentive to consider the social costs associated with denying their services when accessing the risk of delinquent accountholders or checking account applicants. In fact, because checking accounts are "costly for depository institutions to offer and need to be offset with

¹⁵² See Joan Kane, Note, *The Constitutionality of Redlining: The Potential for Holding Banks Liable as State Actors*, 2 WM. & MARY BILL RTS. J. 527, 546 (1993) ("Although not members of any branch of the government, banks are not strictly private actors. By virtue of their essential role in American life, banks are in essence extensions of the government."); see also *supra* note 153. Of course, creditors also provide an important function to families and communities: credit. Policymakers have, in turn, considered the importance of credit and the seriousness of a denial of it, and responded with an array of regulations to control the provision of credit. See *infra* Part IV.

¹⁵³ In *Knickerbocker Life Insurance Co. v. Pendleton*, the Supreme Court declared, "A bank is a quasi-public institution. Its officers have regular and set duties to perform, directly affecting the financial transactions of the entire public. It is essential to the public interest that these duties should be performed with invariable certainty and exactness." 115 U.S. 339, 344 (1885).

¹⁵⁴ See generally Di Lorenzo, *supra* note 74 (advocating for extension of community obligations to variety of financial services industries).

¹⁵⁵ See generally Lynda Edwards, *Big Banker is Watching: In the Brave New Banking World, "Unprofitable" Customers will Find that Bankers Don't Want Them—or Their Money*, BANKRATE.COM (discussing how banks use relationship management software to identify profitable customers), <http://military.bankrate.com/brm/news/bank/19990122.asp> (last visited June 12, 2004). Banks are now capable of distinguishing those applicants who have low incomes from those applicants who have higher incomes using highly sophisticated software. Furthermore, Edwards notes,

[Bank] reps will spot . . . profitable customers using . . . software to analyze an array of factors, including the customer's salary, age, marital status, debt, number of job and residence changes, education and property owned. Customers will be required to supply the data to open an account.

Id.

sufficient revenue (from float and fees) that may not be present in accounts that low-income customers could afford to use,”¹⁵⁶ one may argue that banks have inadvertently exploited the ChexSystems database to remove unprofitable accountholders from their clientele,¹⁵⁷ in spite of intense legislative efforts to bank this very population. A bank consultant bitterly confirmed this in stating, “You charge [lower tier consumers] higher fees because you don’t want them—make them know they’re not welcome.”¹⁵⁸ The industry’s obliviousness to the social costs of their decisions makes government intervention defensible, and even necessary, to accomplish the social ambition of extending access to bank accounts.¹⁵⁹

b. Checking Accounts Do Not Necessarily Have to Extend Credit

Banks may further contend that an applicant’s ChexSystems report is critical to evaluating that applicant for a checking account since these accounts offer overdraft protection features, which are essentially lines of credit that insure non-sufficient fund (NSF) checks (or “overdrafts”).¹⁶⁰ Courts have tended to agree with this reasoning.¹⁶¹

The trouble with this claim is that depository institutions are quite capable of offering checking accounts without overdraft protec-

¹⁵⁶ See Barr, *supra* note 7, at 178–79.

¹⁵⁷ For additional support for this argument, see Gertz, *supra* note 120, at 960–61 (citations omitted) (“Statistics show that eighty percent of a bank’s profit is gained from only twenty percent of their customers. It is therefore no surprise that evidence indicates that banks utilize profiling software not only to [know where to] provide superior customer service, but also to identify their most profitable customers and to ‘fire’ their unprofitable, or even less profitable, customers.”).

¹⁵⁸ Edwards, *supra* note 155; see Marcia Stepanek, *Weblining*, Bus. Wk., Apr. 3, 2000, at EB26 (quoting banking software developer as saying, “Not all customers are created equal.”).

¹⁵⁹ See Di Lorenzo, *supra* note 74, at 120 (“Social decisions that cannot be substantially realized without significant private involvement form a basis for legislative intervention in private decision making.”).

¹⁶⁰ See MARK BUDNITZ & MARGOT SAUNDERS, CONSUMER BANKING AND PAYMENTS LAW § 1.4.3 (2d ed. 2002) (“Overdraft protection is essentially a prearranged line of credit which is triggered when the consumer’s account has insufficient funds to pay a check.”); Fair Credit and Reporting Act (FCRA), 15 U.S.C. § 1681b(3)(A) (permitting consumer reporting agency to furnish consumer report to person who “intends to use the information in connection with a credit transaction”).

¹⁶¹ See generally 11 AM. JUR. 2D *Banks and Financial Institutions* § 937 & n.13 (2004) (citing cases supporting proposition that “[w]hen the payment of check [sic] creates an overdraft, the transaction is deemed a loan”)

tion features.¹⁶² In such a case, it would appear that banks would have little need to run an applicant's name through ChexSystems, as no credit would be extended through the account.¹⁶³

Despite this more sensible alternative, many banks have proven more than willing to deny ChexSystems applicants *any* type of account.¹⁶⁴ Many banks refuse to offer checking accounts that do not feature overdraft protection, and may in fact offer account features that entice consumers to bounce checks, since these transgressions are profitable for banks.¹⁶⁵ This inflexibility in account offerings and the presence of questionable motives raise more doubts about the banking industry's ostensible commitment to serving all consumers, as well as their true reasons for utilizing the ChexSystems network.

B. Banks' Automatic Rejections are Excessive Penalties

Even assuming that banks are not overinclusive in their reporting—either through discriminatory practices or miscalculations

¹⁶² Overdraft protection is often an optional feature that banks offer with transactions accounts. See Fed. Reserve Bd., *Protecting Yourself from Overdraft and Bounced-Check Fees*, <http://www.federalreserve.gov/pubs/bounce/default.htm> (last visited June 12, 2004).

¹⁶³ Under the FCRA, 15 U.S.C. §§ 1681–1681u, one of the permissible reasons for ChexSystems, as a credit reporting agency, to issue a consumer report (or credit report) to a bank is that the bank “intends to use the information in connection with a *credit* transaction” § 1681b(3)(A) (emphasis added). Without overdraft protection, a checking account does not extend credit. See *supra* note 160 and accompanying text. In these circumstances, the non-sufficient fund (NSF) checks would simply be returned to the payee and no credit would be extended to the accountholder. Therefore, under this section, issuing a ChexSystems report would be prohibited.

Another reason that a bank may want to obtain an applicant's ChexSystems report (even for applicants seeking a checking account without overdraft protection) would be to avoid overhead costs in processing NSF checks, often referred to as “bounced-check charges” or “NSF fees.” Under the FCRA, ChexSystems may issue a report to a bank that “has legitimate business need for the information . . . in connection with a business transaction that is initiated by the consumer . . .” § 1681b(a)(F)(i). However, since FCRA does not define “legitimate business need,” it is unclear whether avoidance of these fees is sufficient to constitute a “legitimate business need.”

¹⁶⁴ See Beckett, *supra* note 1; NCIF REPORT, *supra* note 20 (discussing “reduced-risk” products).

¹⁶⁵ See Chu, *supra* note 5. Chu notes:

Another development that could lead to more consumers landing in [the ChexSystems] database: the advent of the “courtesy overdraft.” In recent years, banks have ramped up their fee income by adding this feature to their service lineup. Banks will cover some of consumers' bounced checks and then charge them a fee, typically between \$20 to \$30, per financial transgression. . . . Critics say this net could . . . ensnare those who don't pay the money back quickly enough. “The same banks that are using ChexSystems to blackball consumers who got in trouble managing bank accounts are actively enticing them to overdraw their bank accounts[.]”

Id.; see also *supra* note 60 and accompanying text (noting that many banks are opening CCOs to capture higher profits).

of a consumer's ability to responsibly handle a checking account—banks have *still* placed too much weight on an applicant's ChexSystems file. In one of the few studies examining the weight banks actually give to an applicant's ChexSystems report prior to opening checking accounts, the National Community Reinvestment Coalition (NCRC) found that all of the banks that responded to their survey considered an applicant's ChexSystems file prior to opening checking accounts.¹⁶⁶ Furthermore, "[f]ive of the six banks rated the ChexSystems database as *the most important factor* in the decision to grant a checking account."¹⁶⁷

In practice, banks consider the mere *existence* of a ChexSystems file as dispositive in determining an applicant's creditworthiness, and do not scrutinize the file's content.¹⁶⁸ Banks in turn pay short shrift to other relevant factors in evaluating an applicant's ability to maintain a checking account responsibly.¹⁶⁹ Moreover, since ChexSystems, unlike other credit bureaus, neither collects nor maintains consumers' favorable checking account histories, an applicant's ChexSystems file presents banks with a skewed picture of an applicant's creditworthiness by focusing solely on the applicant's negative relationship with checking accounts. Naturally, this skewed reporting compromises a

¹⁶⁶ NCRC REPORT, *supra* note 20, at 3 (surveying six banking institutions' ChexSystems policies).

¹⁶⁷ *See id.*, at 3–4 (emphasis added).

¹⁶⁸ *See, e.g.,* Beckett, *supra* note 1; Quinn, *supra* note 23.

¹⁶⁹ *See supra* note 106 and accompanying text; *see also* Underwood, *supra* note 131, at 1417 ("A decisionmaker who selects and excludes individuals on the basis of their predicted behavior tends to view the prediction as a fixed attribute of the applicant, and tends not to consider ways of intervening to change the situation."). In contrast, most other creditors, such as credit card companies, employ credit bureaus that calculate a "credit score," which considers other statistically predictable factors in assessing an applicant's risk. By way of background, when assessing an applicant's creditworthiness, banks may use a judgmental system, a credit score system, or some combination of both. *See* Loonin & Wu, *supra* note 130, § 6.3.1. Essentially, a credit score system is largely an objective, methodical process of evaluating applicants that assigns a score to each applicant, *see* Reg. B, 12 C.F.R. § 202.2(p)(1), while a judgmental system is a subjective method of evaluating applicants. *See id.* § 202.2(t); Loonin & Wu, *supra* note 130, § 6.3.3. In evaluating deposit-account applicants' creditworthiness through ChexSystems reports, banks utilize the judgmental system approach, thus "allow[ing banks] flexibility to consider mitigating factors that would turn an otherwise unacceptable risk into [an acceptable risk]." RITA GORDON PEREIRA, CREDIT DISCRIMINATION § 6.3.1.3 (2d ed. 1998). Therefore, banks, at their discretion, are capable of considering additional pertinent aspects of an applicant's past financial history aside from the existence or non-existence of the applicant's ChexSystems file. While "[h]uman judgment is by no means infallible," it does "contain[] insight that is not quantifiable." *Id.* *But see supra* Part III.A.I (suggesting that wide discretion in evaluating deposit applicants may conceal bank's discriminatory behavior); Loonin & Wu, *supra* note 130, § 6.3.3 (recognizing that "leeway given to creditors can also perpetuate past patterns of discrimination because employees are apt to approve applicants most similar to those found suitable in the past").

bank's ability to make an accurate evaluation of an applicant's overall ability to maintain a checking account.¹⁷⁰

The next three Sections outline a few relevant aspects of an applicant's ChexSystems report that banks have often ignored: (1) the report's age; (2) the reason that the applicant was initially reported; and (3) the applicant's satisfaction of the outstanding debt.¹⁷¹ This Section concludes that banks would gain a more accurate and complete idea of an applicant's creditworthiness—especially for those low-income consumers who often demonstrate creditworthiness through non-traditional credit factors that banks and credit bureaus have ignored¹⁷²—by considering additional factors beyond the mere existence or non-existence of a ChexSystems file.

1. *The Report's Age*

Of course, the older a ChexSystems report is, the less relevant it would appear to be in predicting an applicant's current or future financial behavior. This proposition would seem to be all the more true when accounts are reported for fairly small amounts.¹⁷³ The NCRC study reported, however, that “five of the six banks indicated that they deny checking accounts if the ChexSystems record is 5 years old.”¹⁷⁴ Much like when evaluating traditional credit reports, banks should consider whether an applicant's ChexSystems report continues to be relevant—and, if so, how relevant—when it assesses an applicant's creditworthiness.¹⁷⁵

2. *Reasons for Reporting*

When determining whether to open a checking account for an applicant, banks have neglected to consider the reasons a particular

¹⁷⁰ Robert B. Avery et al., *An Overview of Consumer Data and Credit Reporting*, 89 FED. RES. BULL. 47, 72 (2003), available at <http://www.federalreserve.gov/pubs/bulletin/2003/0203lead.pdf>.

¹⁷¹ Each of these factors are currently reported to ChexSystems. See EFUNDS AND DATA PRIVACY, *supra* note 111, at 2.

¹⁷² See generally M. Cary Collins et al., *The Influence of Bureau Scores, Customized Scores, and Judgmental Review on the Bank Underwriting Decision-Making Process*, in CHANGING FINANCIAL MARKETS, *supra* note 7, at 103.

¹⁷³ See *supra* Part II.

¹⁷⁴ See NCRC REPORT, *supra* note 20; Beckett, *supra* note 1.

¹⁷⁵ Notably, soon after the 2000 WSJ article, *supra* note 1, some banks vowed to disregard applicants' ChexSystems report after a certain amount of time. See *infra* note 217. But see *supra* note 6 (“The same banks that are using ChexSystems to blackball consumers who got into trouble managing bank accounts are actively enticing them to overdraw their bank accounts.”).

applicant was reported to ChexSystems by her prior bank.¹⁷⁶ Consequently, an applicant who was reported to the database for a \$25 delinquent account would be rejected just as if she were an applicant with a \$10,000 delinquent account, or worse, an applicant who was reported for suspected fraud. Surely, however, an applicant reported to the database for a modest debt or a mere oversight should be evaluated differently from an applicant who was reported for suspected fraud.¹⁷⁷

3. *Satisfying the Outstanding Debt*

Additionally, if a bank is trying to assess whether an applicant might not make good on her overdrafts, it should be relevant whether the applicant has repaid the debt to her prior bank.¹⁷⁸ For many low-income families who are living paycheck-to-paycheck, temporary financial setbacks are often unavoidable, inevitably causing some debts to become delinquent. Regardless of a consumer's willingness to pay or even her generally responsible financial habits, these occasions are simply part of what it means to be poor. As John Taylor, former president of the NCRC, stated, "No one is asking banks to do business with people who are such a risk that the banks will never see their money again. But that's a long stretch from low- and moderate-income people who require more latitude and consideration."¹⁷⁹

Banks will get a more accurate depiction of an applicant's creditworthiness by examining the foregoing factors. Referring to loans (but equally applicable here), Professor Barr suggests that banks could also look to an applicant's "strong record of paying rent and utilities on time" as an indicator of risk.¹⁸⁰ Of all the factors that will determine a low-income consumer's creditworthiness, her present condition (as opposed to her past infractions) seems to be most relevant.¹⁸¹

¹⁷⁶ See Beckett, *supra* note 1 ("[E]Funds is developing . . . a scoring system that more precisely evaluates . . . riskiness. The database divides entries into categories ranging from 'writing checks on a closed account' to 'possible forgery'"); Connery, *supra* note 16, at 15 ("In many cases[,] a ChexSystems record is the result of a single event that occurred as many as five years prior.").

¹⁷⁷ Even for applicants reported for suspected fraud, the process should ensure that these applicants are in fact legitimately suspected.

¹⁷⁸ Quinn, *supra* note 23.

¹⁷⁹ Beckett, *supra* note 1.

¹⁸⁰ Michael S. Barr, *Credit Where It Counts: The Community Reinvestment Act and Its Critics*, 80 N.Y.U. L. REV. 513, 538 (2005).

¹⁸¹ Through an informal study, the National Community Investment Fund found that a couple of ChexSystems member banks "consider other factors in addition to the ChexSystems report, including rent, employment history, and other sources of income." NCIF REPORT, *supra* note 20, at 3.

Of course, banks must make financially sound decisions. But, this consideration is not in tension with the argument that they should make a more holistic evaluation of checking account applicants, and should not rely on a myopic view of a consumer's ChexSystems file.¹⁸² Unless banks start to consider additional aspects of a consumer's creditworthiness beyond the mere existence or non-existence of a ChexSystems file, societal legislative efforts to move unbanked consumers into mainstream banks will be substantially thwarted.¹⁸³

IV

SEARCHING FOR A RESTRAINT

Acknowledging that financial institutions discriminate in credit markets, Congress, beginning in the 1970s, enacted a broad range of legislation to prevent discrimination against minority and low-income communities in the credit market.¹⁸⁴ State governments have made similar efforts. In enacting these laws, legislatures across the country have acknowledged the significance of credit in restoring distressed communities and building a family's long-term wealth.

By the same token, as this Note has propounded, access to checking accounts is also critical to restoring distressed communities, if only because access to a checking account is often a prerequisite to

¹⁸² Of course, even after considering these additional aspects of an applicant's history, banks must still weigh them against one another in making a decision about whether to approve an applicant. This process should pose no difficulty, since banks regularly perform the same process in considering whether to approve loan applicants.

¹⁸³ To be practical, this proposal requires industry-wide participation. That is, where industry-wide cooperation is absent, banks that might otherwise be willing to consider these additional aspects of ChexSystems applicants' history will be reluctant to for fear that they will bear a disproportionate share of the consumers who are on ChexSystems, by allowing other non-participating banks to freeride off their efforts. Cf. generally Clayton P. Gillette, *Regionalization and Interlocal Bargains*, 76 N.Y.U. L. REV. 190 (2001) (discussing burden sharing and interlocal cooperation between localities).

¹⁸⁴ Professor Barr classifies this legislation into five areas:

First, CRA sets forth a broad affirmative obligation on insured depository institutions to lend in their services areas. Second, negative prohibitions, such as the Equal Credit Opportunity Act (ECOA), bar discrimination against minority borrowers. Third, disclosure laws may be thought of as having two sub types. Some laws, such as the HomeMortgage Disclosure Act (HMDA), assist in the enforcement of other legal rules or social norms by requiring public disclosure of lending data. Other disclosure laws, such as the Truth in Lending Act (TILA), provide information to consumers to ensure a well-functioning market and are backed by enforcement of the disclosure requirement. Fourth, Congress enacted substantive regulation restricting certain loan products in the Home Owners Equity Protection Act (HOEPA). Fifth, government subsidies are pervasive in the housing credit market.

Barr, *supra* note 180, at 624-25.

credit approvals.¹⁸⁵ However, although Congress has expressed a strong desire to provide access to checking accounts to financially responsible consumers, it has yet to recognize banks' ability to undercut these efforts—and thereby undercut efforts to extend loans and mortgages to distressed communities¹⁸⁶—through exploiting the ChexSystems network. In an effort to search for a viable solution, this Part considers potential legal challenges that might be brought against the abuse of the ChexSystems database.

This Part proceeds as follows: Section A briefly reviews the Fair Credit Reporting Act and concludes that the Act does not provide protection for aggrieved ChexSystems consumers. Section B reviews the Equal Credit and Opportunity Act (ECOA) and finds that, although Congress intended to cover these types of problems, the Act may be difficult to enforce. Finally, Section C looks to the Community Reinvestment Act (CRA) for direction, and argues that the CRA, though an imperfect tool, should be understood to protect communities from the abuses present in the industry's exploitation of ChexSystems.

A. *The Fair Credit Reporting Act*

Acknowledging that “[t]he banking system is dependent upon fair and accurate credit reporting,”¹⁸⁷ Congress enacted the Fair Credit and Reporting Act of 1970.¹⁸⁸ Among its most important requirements, the Act “require[s] that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit . . . in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information.”¹⁸⁹ Under the Act, ChexSystems qualifies as a “credit reporting agency,”¹⁹⁰ and a Chex-

¹⁸⁵ See Belsky & Calder, *supra* note 27, at 23–24; Sherraden & Barr, *supra* note 41, at 25–26.

¹⁸⁶ Cf. CASKEY, *supra* note 38, at 9 (“Our society devotes substantial resources to protecting consumers in the financial markets and institutions serving middle- and upper-income households.”).

¹⁸⁷ Fair Credit Reporting Act of 1970, Pub. L. No. 91–508, 84 Stat. 1128 (codified as amended at 15 U.S.C. § 1681 (1976 & Supp. V 1981)).

¹⁸⁸ *Id.*

¹⁸⁹ 15 U.S.C. § 1681(b) (2000).

¹⁹⁰ See *id.* § 1681a(f). For cases that support this proposition, see *Nicholl v. Nationsbank of Georgia*, 488 S.E.2d 751, 753 (Ga. Ct. App. 1997); *Estiverne v. Saks Fifth Ave.*, 9 F.3d 1171, 1173 (5th Cir. 1993); *Greenway v. Info. Dynamics, Ltd.*, 524 F.2d 1145, 1146 (9th Cir. 1975); *Peasley v. TeleCheck of Kansas*, 637 P.2d 437, 442 (Kan. Ct. App. 1981). The FTC agrees with this position also. See, e.g., *Howard Enterprises, Inc.*, 93 F.T.C. 909, 910 (1979) (consent order); *Interstate Check Sys.*, 88 F.T.C. 984, 984–85 (1976) (consent order).

Systems report qualifies as a “consumer report.” ChexSystems is therefore subject to the Act’s obligations.¹⁹¹

However, unless an aggrieved consumer asserts that her ChexSystems report contains inaccurate information due to ChexSystems’s lack of reasonable procedures to maintain the accuracy of its reports,¹⁹² she has no claim of wrongdoing under the Act.¹⁹³ The Act exclusively covers the *accuracy* of consumer reports, not the *weight* given to reports by creditors. Because banks have given disproportionate weight to ChexSystems reports, however, even a consumer’s *accurate* ChexSystems report presents all of the problems of overinclusiveness and overreliance discussed in Part III.¹⁹⁴ The FCRA will therefore fail to protect consumers from the banking industry’s overreliance on ChexSystems reports.

B. *Equal Credit Opportunity Act*

As discussed, numerous studies have documented lending institutions’ discriminatory practices against creditworthy, minority applicants.¹⁹⁵ Such discrimination may be operating here, in that some banks may employ ChexSystems as a pretextual basis for denying checking accounts to minority applicants. After all, “[banks] rarely will state that they are discriminating on a prohibited basis.”¹⁹⁶

In 1974, Congress enacted the Equal Credit Opportunity Act to combat lending discrimination.¹⁹⁷ The Act provides: “It shall be unlawful for any creditor to discriminate against any applicant, with

¹⁹¹ See generally 16 C.F.R. pt. 600 (1999).

¹⁹² 15 U.S.C. § 1681(a), (b); see, e.g., *Nicholl*, 488 S.E.2d at 754 (finding that “evidence [was] insufficient to establish [that bank] furnished information to ChexSystems with malice or willful intent to injure”).

¹⁹³ In any case:

Credit bureaus’ customers are *not* the consumers on whom they report. Rather, the real customers are the credit grantors who subscribe to the credit bureaus’ services. This creates a precarious relationship between credit bureaus and consumers. The consumer’s ability to access credit depends on credit bureaus’ accuracy in documenting his or her credit history, as well as the bureau’s prompt compliance in correcting mistakes once they are discovered. Yet, when consumers are confronted with a credit bureau that refuses to correct inaccurate information, the consumers cannot ‘vote with their feet’ and change to another credit reporting agency. This can cause large problems for consumers, because credit reports are often inaccurate, and consumers have inordinate troubles in getting erroneous reports corrected.

ANTHONY RODRIGUEZ ET AL., *FAIR CREDIT REPORTING* 5 (5th ed. 2002).

¹⁹⁴ See, e.g., *Nicholl*, 488 S.E.2d at 754 (denying plaintiff’s claim against reporting bank since plaintiff could not prove that reporting bank willfully intended to injure in violation of FCRA).

¹⁹⁵ See *supra* Part III.

¹⁹⁶ PEREIRA, *supra* note 169, § 3.3.2.

¹⁹⁷ 15 U.S.C. §§ 1691–1691f.

respect to any aspect of a credit transaction . . . on the basis of race, color, religion, national origin, sex or marital status, or age.”¹⁹⁸ Under ECOA, the Treasury Department’s Regulation B prohibits discrimination in “every aspect of an applicant’s dealings with a creditor regarding an application for credit.”¹⁹⁹ Since courts have classified an “overdraft” as credit, checking accounts with overdraft protection fall under the ECOA’s supervision.²⁰⁰ Banks, as creditors, will thus be subject to ECOA’s regulations in a substantial portion of ChexSystems cases.

To bring an ECOA claim, a plaintiff must prove that a creditor discriminated against her on at least one of the prohibited bases.²⁰¹ Courts have developed two approaches to prove such discrimination: the disparate impact test and the disparate effects test.²⁰² Each of these tests are intended to expose cases where creditors cite a “legitimate business reason” as a disguise for impermissible discrimination when rejecting applicants protected under the Act.

Although in theory it might be possible under either of these tests to show that a bank employed a ChexSystems file as a pretext for racial discrimination,²⁰³ an applicant will face substantial evidentiary problems in making that claim.²⁰⁴ An aggrieved applicant would have to prove either: (1) that a bank’s actual reason for denial was racial discrimination and not the applicant’s ChexSystems file; or (2) that the bank sometimes ignored white applicants’ ChexSystems files while almost always refusing to ignore minorities’ ChexSystems files. In either case, experience under ECOA or other civil-rights statutes demonstrates that such proof will, in practice, be nearly impossible to establish.²⁰⁵

¹⁹⁸ 15 U.S.C. § 1691(a).

¹⁹⁹ Reg. B, 12 C.F.R. § 202.2(m); *see id.* § 202.4.

²⁰⁰ As mentioned in Part III.A.2.b, for deposit accounts that do not offer overdraft protection, there is little reason why a bank would check an applicant’s ChexSystems report, as no credit would be extended. *See supra* notes 160 & 163 and accompanying text.

²⁰¹ Regulation B defines “discrimination” as “to treat an applicant less favorably than other applicants.” 12 C.F.R. § 202.2(n).

²⁰² Loonin & Wu, *supra* note 130, §§ 4.1–4.4.

²⁰³ *See supra* Part III (discussing *Kelly* case); PEREIRA, *supra* note 169, § 4.2.2 (“Most credit discrimination today appears to occur among those marginally qualified.”).

²⁰⁴ *See* Scott Ilgenfritz, *The Failure of Private Actions as an ECOA Enforcement Tool: A Call for Active Governmental Enforcement and Statutory Reform*, 36 U. FLA. L. REV. 447, 458 (1984) (noting that “[t]he primary obstacle to successfully proving disparate impact is the necessity of showing a statistical discrepancy sufficient to establish a prima facie case”); *id.* at 460 (“[W]hile the ECOA’s general proscription of inquiry into prohibited bases of discrimination serves the purposes of the Act by reducing the likelihood of willful discrimination, it also prevents plaintiffs from conclusively proving disparate impact.”).

²⁰⁵ In the mortgage context, researchers employed paired black and white “testers” to uncover a bank’s discriminatory practices. *See, e.g.*, Cathy Cloud & George Galster, *What*

C. *The Community Reinvestment Act*

In 1977, Congress enacted the Community Reinvestment Act²⁰⁶ (CRA) to make financial institutions more responsive and accountable to their communities' banking needs, particularly low-income and minority communities. The Act specifically provides for "regulated financial institutions . . . [to] serve the convenience and needs of [their] communities [including minority and low-income communities] . . . [which] include the need for credit services *as well as deposit services* . . . with the safe and sound operation of such institutions."²⁰⁷

The Act further requires CRA regulators to periodically examine a financial institution's compliance with the Act's mandates. Based on that examination, CRA regulators assign each financial institution a CRA score.²⁰⁸ These scores are in turn considered when a financial institution applies to the federal government for expansion or merger.²⁰⁹ Under the Act, community-based organizations also play a critical role in enforcing the CRA through negotiations with their community's financial institutions. As Professor Anthony Taibi notes,

A majority of CRA challenges have been withdrawn after applicant institutions and local groups negotiated settlements. Such settlements often specify what measures the applicant institution must take to improve its record in low- and moderate-income and non-White communities. . . . These agreements have generated between \$7.5 and \$20 billion in targeted loan commitments to low- and moderate-income areas, which far exceeds the conditions that would have been imposed by regulators.²¹⁰

While the CRA is extremely controversial in many respects,²¹¹ critics and advocates have had a propensity to focus on the Act's lending directives. Notably, however, the plain language of the Act extends financial institutions' community responsibilities to deposit

Do We Know About Racial Discrimination in Mortgage Markets?, 22 REV. OF BLACK POL. ECON. 101, 103 (1993) (finding that black and white applicants with same expense/income ratios were treated differently); *Richardson v. Howard*, 712 F.2d 319, 321 (7th Cir. 1983) (approving use of testers in fair housing litigation); *Zuch v. Hussey*, 394 F. Supp. 1028, 1051 (E.D. Mich. 1975) (same).

²⁰⁶ 12 U.S.C. §§ 2901–2906 (1988 & Supp. IV 1992).

²⁰⁷ 12 U.S.C. §§ 2901(a)(2)–2901(b) (emphasis added).

²⁰⁸ See Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165, 199–200 (1993).

²⁰⁹ 12 U.S.C. § 2903.

²¹⁰ Taibi, *supra* note 132, at 1488.

²¹¹ See generally Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 293 (1993); Marsico, *supra* note 208, at 172 (describing how "social developments" have led to increased CRA enforcement activity); Barr, *supra* note 7, at 233–35 (discussing role CRA could play in providing banking opportunities for low-income consumers).

services as well as to their lending services.²¹² Critics and advocates have largely overlooked the Act's "deposit services" directive.²¹³ Yet, it is precisely this characteristic of the CRA that may provide the key to restraining the banking industry's exploitation of ChexSystems. While a bank has:

discretion to develop, on its own and using its own judgment, the sorts of loans and services it will offer to meet community credit needs[, a] bank's discretion is not unqualified. Rather, the bank must exercise it in a way that is consistent with the purposes of the CRA and must offer credit [and deposit services] which [are] designed to meet the community's [banking] needs.²¹⁴

In evaluating whether a bank has met its community's "deposit services" needs, CRA examiners should consider how banks have utilized ChexSystems when assigning CRA scores to these institutions. Have banks exploited ChexSystems, as explained herein, or have they employed the database sensibly by considering the effects to the community? Similarly, when negotiating with banks, community-based organizations should also consider whether banks have not only met the deposit needs of their community "with the safe and sound operation of such institutions"²¹⁵ but also examine whether banks have illegitimately used the database to avoid meeting these community deposit services needs.²¹⁶

Among the questions these examiners should be asking are: First, has the bank cited "legitimate business concerns" as a way of cloaking their actual motivations? Secondly, has the bank needlessly reported accountholders to ChexSystems where there were less excessive options available, such as offering checking accounts without overdraft protection (as discussed in Part III)? Equally important, has the bank categorically rejected *any* applicant simply because she appears in the database, while disregarding mitigating factors (such as those discussed in Part III)? Lastly, has a bank exercised less toler-

²¹² Federal regulators have taken the position that they will not penalize a bank under the CRA for not offering low- or no-cost checking accounts to its community low-income members. See Marsico, *supra* note 208, at 243. While I question this rationale, this Note's goal is not to convince regulators that this rationale is wrong. Rather, this Note's position is more fundamental than that: Banks' divestment—as opposed to bank investment—of an accountholder's deposit account, as well as banks' power to "blacklist" former accountholders, should be examined in CRA examinations.

²¹³ *Cf.*, Marsico, *supra* note 208, at 183 ("[C]ommunity credit needs can also encompass banking services such as low cost and low minimum balance savings and checking accounts, automatic teller machines, or increased hours and teller services.").

²¹⁴ Marsico, *supra* note 208, at 197–98.

²¹⁵ 12 U.S.C. § 2901(b).

²¹⁶ This Note presumes that bank regulators have more time, money, expertise, and face a lower bar to establishing discrimination than individual litigants. See *supra* Part IV.B.

ance in reporting minority or lower income accountholders to ChexSystems? All of these considerations go to the heart of whether banks are truly committed to providing a community with deposit services.²¹⁷

CONCLUSION

In our modern financial economy, access to a bank account is critical. As one commentator put it, “[A] bank account is the first little step to wealth accumulation.”²¹⁸ Unfortunately, access to bank accounts is dominated by large financial institutions that have historically expressed a strong aversion to lower-income, minority consumers. Acknowledging that financial institutions cannot be trusted to serve certain segments of the population fairly, federal and state governments have enacted a broad range of legislation to ensure that every creditworthy consumer has access to a checking account. Yet legislatures have somehow overlooked the ChexSystems database. As this Note has shown, ChexSystems has become a very real barrier to millions of consumers’ ability to control their financial lives.

Advocates argue that ChexSystems provides financial institutions with the means to share information about accountholders. But ChexSystems also provides these institutions with a powerful—and seemingly “legitimate”—tool to exclude the same population that has long been given the cold shoulder by these institutions. In a very real sense, then, ChexSystems undermines efforts to provide equal financial opportunities to all creditworthy consumers. This Note hopes to flag the ChexSystems database as a problem that warrants legislative attention, while at the same time reminding regulators, community-based organizations, and advocates that the CRA may (without the need for modification) already provide us with a powerful tool to curb banks’ unwarranted exclusions of those who require access to bank accounts perhaps more than anyone else.

²¹⁷ Some banks’ efforts to curb the harshness of ChexSystems demonstrate that these solutions are practical. See Paul Beckett, *Banks Relax Use of Bad-Checks List to Vet Applicants*, WALL ST. J., Oct. 2, 2000, at C29; Paul Beckett, *Check Rules Ease at Bank of America*, WALL ST. J., Sept. 28, 2000, at C1.

²¹⁸ Rochelle Stanfield, *Capitalism for the Poor*, NATIONAL J., July 11, 1998, http://gwb.web.wustl.edu/csd/Areas_Work/Asset_building/News_articles/capitalism.html.