BLACKLISTED

How ChexSystems Contributes to Systemic Financial Exclusion
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I. EXECUTIVE SUMMARY

Under the leadership of Treasurer José Cisneros, the San Francisco Office of Financial Empowerment (OFE) strives to ensure that every San Franciscan has access to a safe and affordable bank account. Unbanked rates have fallen both locally and nationally, yet many of our residents continue to live outside of the financial mainstream, relying on expensive and often predatory fringe financial services. Research from the Federal Deposit Insurance Corporation (FDIC) finding that nearly 50 percent of unbanked people were previously banked led OFE to embark on a research initiative to better understand why some consumers – especially those with a past banking history – remain unbanked.

This initiative revealed deep problems associated with bank account screening consumer reporting agencies, which provide financial institutions with (mostly negative) information about people’s banking histories and are used by banks and credit unions to decide whether to allow someone to open an account. OFE examined how account screening practices contribute to financial exclusion, focusing on the use of ChexSystems, one of the two agencies that dominate this industry. Following consumer and stakeholder interviews and surveys and review of ChexSystems reports for financial coaching clients, OFE found numerous flaws with the system’s current design and implementation, including a lack of consumer awareness, unfair and unequal outcomes, and a dispute resolution process that is nearly impossible to navigate.

Involuntary account closures and ChexSystems records can be devastating, and the use of these systems has resulted in a regime that systemically excludes consumers, with a disproportionate impact on Black consumers. To address the flaws in the system, OFE recommends urgent reforms to agencies like ChexSystems and the financial institutions that use them that will enhance the transparency, accessibility, and fairness of the system. These reforms include creating clear and uniform definitions and policies related to banking history data, reducing the impact of overdrafts on account closures and denials, eliminating the use of account screening consumer reporting agencies for customers opening Bank On certified accounts, and developing robust resolution processes that create pathways to banking for consumers. OFE also outlines recommendations for financial coaches and others helping consumers navigate this opaque account screening system, including making review of ChexSystems reports a standard practice and helping clients overcome barriers related to these reports and their use by banks and credit unions.
II. INTRODUCTION

Treasurer José Cisneros and the Office of Financial Empowerment (OFE) launched the groundbreaking Bank On San Francisco program nearly 15 years ago after realizing that many residents of San Francisco had no bank account (“unbanked”), and instead relied on costly fringe financial products such as payday lenders and check cashers. Bank On San Francisco spurred a national movement and a national coalition of cities working to improve access to safe and affordable bank accounts for all who desire and need one. Bank On San Francisco boasted strong initial success, with unbanked rates dropping from an estimated 15-20 percent in 2005 to 2.8 percent in 2019. However, unbanked rates remain persistently high for certain populations. For example, 42 percent of Black clients enter OFE’s financial coaching program unbanked, compared with 32 percent of clients overall. This local data reflects disparities in mainstream banking access nationally, as 13.8 percent of Black households and 12.2 percent of Latinx households were unbanked as of 2019, compared to only 2.5 percent of white households.

According to the Federal Deposit Insurance Corporation (FDIC)’s most recent survey of household banking practices, slightly more than 50 percent of people who are unbanked had a bank account at some point in the past. With so many previously banked people now unbanked, it is clear that any effort to reduce unbanked rates must recognize this constituency and their concerns and needs.

To understand why these individuals are currently unbanked, OFE embarked on a research initiative to study reasons why people remain unbanked, including debt collection and bank levies, fears around asset limits in public benefit programs, and distrust of mainstream financial institutions. The focus of this follow-up report is another systemic barrier to banking: the denial of customer applications by banks based on negative consumer banking data – especially involuntary account closures – held in the records of bank account consumer account screening agencies like ChexSystems. ChexSystems, a subsidiary of Fidelity National Information Services
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ChexSystems Inc. (commonly referred to as ChexSystems) is a consumer reporting agency that tracks people’s banking histories. Financial institutions report information about customers to ChexSystems, and then ChexSystems compiles and reports that information back to financial institutions for a fee. Banks rely on this information to screen prospective clients and, theoretically, to prevent account fraud. ChexSystems is governed by the Fair Credit Reporting Act and shares similarities with credit reporting agencies like Equifax and Transunion. However, unlike traditional credit reporting agencies, ChexSystems reports mostly negative information, such as involuntary account closures.
account closures. An estimated 80 percent of all banks and credit unions use ChexSystems or other consumer reporting agencies such as Early Warning Services to decide whether to allow a customer to open a checking or savings account.\textsuperscript{vii}

Reports compiled by ChexSystems include information on customers' banking history: involuntary account closures and inquiries. Involuntary account closures occur when a bank or credit union forcibly closes a client’s account, typically because of overdrafts or other “account mismanagement.” Generally, records of account closures remain on a report for five years.\textsuperscript{viii} Involuntary account closures are reported in ChexSystems either as closures for (1) account abuse or (2) suspected fraud based on the severity of the action and the account holder’s motivation. Banks have discretion to select the reason for account closure, and distinctions aren’t clear (this issue is discussed in greater depth below). However, based on conversations with ChexSystems and financial institutions, the following rough definitions emerged:

> **Account Abuse** typically involves account mismanagement and unpaid debt on an account without intention on the consumer’s part to misuse the account for financial or personal gain. Bank policies vary, but a record for account abuse will typically result in a consumer being unable to open a new account for five years unless they pay their debt.

> **Suspected Fraud** typically involves suspicion of intentional misuse of an account for financial or personal gain. Since it is deemed more severe, a record for suspected fraud typically results in consumers being unable to open a new account for five years regardless of whether the debt is repaid.

The second component of a ChexSystems report is inquiries. Inquiries signify that a consumer has applied for a financial product, like a bank account or payday loan, though they do not represent actual use of the product. Like account closures, inquiries are separated into two categories: demand deposit account (DDA) inquiries and non-demand deposit account (non-DDA) inquiries.

> **Demand deposit account (DDA) inquiries** include details on a consumer’s applications for checking or savings accounts.

> **Non-demand deposit account (non-DDA) inquiries** include details on a consumer’s application for financial products outside of traditional bank accounts, such as payday loans, installment loans, auto title loans, and more.

The following figure outlines the components of a ChexSystems report.
III. KEY ISSUES IDENTIFIED WITH CHEXSYSTEMS

While individual banks and credit unions utilize ChexSystems in a way they consider to be neutral to prevent fraud and manage risk, OFE’s research revealed systemic issues in both ChexSystems’ design and implementation, resulting in significant confusion and unfairness and ultimately undue exclusion for low-income consumers, and in particular Black consumers. The four main problems uncovered through our research and interview process include:

> **Unclear, Unfair and Unequal Treatment** – individuals do not understand why they have a record and banks choose to close accounts and categorize those closures in an arbitrary, unfair, and unequal manner

> **Ambiguous Impact of Inquiries** – inquiries should not count against consumers and prevent consumers from opening accounts, but they appear to

> **Impossible Resolution** – it is nearly impossible for a consumer to resolve a ChexSystems record via a dispute and resolution via debt repayment varies from bank-to-bank with limited information available to consumers

> **Individual Impacts, Systemic Exclusion** – ChexSystems records worsen individuals’ financial vulnerabilities and have a disproportionate impact on Black consumers

The impacts of ChexSystems records are tangible, devastating, and widespread in San Francisco and across the country. Individuals are faced with unintelligible and unfair outcomes and are unable to escape the system. Taken together, these individual cases result in a system that is mostly unknown, indcipherable, and inequitable, and results in systemic exclusion from the financial mainstream for the clients OFE is most dedicated to serving.

**Unclear, Unfair and Unequal Treatment**

ChexSystems is utilized within an almost completely opaque system, which allows banks to report and categorize involuntary account closures in arbitrary, unfair, and unequal ways. In most instances, individuals do not understand that they have a ChexSystems record or the reason behind that record. Banks are afforded almost complete discretion regarding involuntary account closures, including the rationale for the closure and the type of closure reported to ChexSystems. This discretion results in unfair outcomes, where unwitting and good faith activity can be considered
and reported as suspected fraud or account abuse. Additionally, lack of definitional clarity results in unequal outcomes, where similar activity can be categorized as either suspected fraud or account abuse, and financial institutions may use the debt owed as a proxy for severity of the offense.

**Unclear Records – People do not know they have ChexSystems records**

A primary issue OFE uncovered with ChexSystems records is that there is little-to-no consumer understanding or awareness of the system or its implications. While 25 percent of financial coaching clients whose records were reviewed had an involuntary account closure reported to ChexSystems, very few of these clients knew about this record or understood how it could impact them in the future. Once people learned about the record from a financial coach, most were still not clear about the exact activity that resulted in the account closure and ChexSystems record. As one client, N.G., put it:

“No I really never understood what a ChexSystems record was. [My coach was the] first person that described it me – I knew there was some sort of information that was going to be reported.”

**Unfair Treatment – Good faith activity can result in ChexSystems records**

Though ChexSystems records ostensibly are used to prevent fraud and root out malicious consumers, the majority of records result from repeated overdrafts or other unwitting or good faith behavior. OFE’s research found numerous clients who had their accounts closed due to repeated overdrafts or because they were victims of fraud or even because of bank error.

Most ChexSystems records result due to overdraft or non-sufficient fund transactions – which occur when a consumer does not have enough money in their account to cover a transaction, but the bank processes it anyway, leading to a negative account balance – rather than fraudulent behavior. One 2008 study found that 97.5 percent of account closures reported to ChexSystems were due to overdrafts.\textsuperscript{xix} Overdraft practices are highly profitable to banks – with banks earning an estimated $11 billion in overdraft fees in 2019 – and banks’ own practices and account structures can contribute to the prevalence of repeated overdrafts and involuntary account closures. Closures triggered by overdraft are often the result of outstanding unpaid debt that consists mostly of fees, which dwarf the actual amounts withdrawn and represent profit rather than loss recovery for banks.\textsuperscript{xi}

Though a comprehensive discussion of overdraft is beyond the scope of this report, there are numerous issues with the overdraft system: banks pressure consumers to open accounts with overdraft enabled and then impose high fees; banks re-order transactions from high-to-low to maximize fees (a practice now banned for banks regulated by the FDIC). Overdraft fees and resulting account closures can be devastating for clients, but they are also entirely preventable and within banks’ control. Many accounts, such as Bank On-certified accounts, simply do not permit negative balances. One client, S.T., who dealt with account closures due to overdrafts explained:

“I didn’t put any money in [my account] and wasn’t really managing it well. My account overdrafted and was closed after multiple purchases. The notification came later. I told [the bank] that when I was in the financial situation to pay them back I would and that’s what I did.” After these incidents, S.T. made the decision not to bank for a while “because there’s always something that could go wrong.”

Aside from repeated overdrafts, other good faith activity can be labeled as account abuse and result in involuntary account closure. Frequently this occurs when individuals are taken advantage of by acquaintances as happened to A.R.:
A.R. was a long-time member of a local credit union, having opened her account more than ten years prior when she was preparing to attend college. She loved the credit union she banked with and valued the connection she built with branch staff: “That was important to me as I started learning and growing financially – building a relationship with my bank.” In November 2019, A.R.’s account was abruptly closed for account abuse. She had been cashing checks for a family friend who didn’t have her own bank account and wanted to avoid costly check cashing fees. A.R. cashed checks for the family friend a few times before the friend provided A.R. with a bad check. A.R. believed that the check had fully cleared, explaining that if she had understood that the check did not clear she would have waited to withdraw the funds. She realized she was a victim of fraud when the friend became unreachable by phone and moved out of California.

This bad check left A.R. owing nearly $1,000 to the credit union. “I felt really sad after they closed my account... When this situation happened, and this person put a wall between me and my bank, I was furious. I wasn’t trying to hurt the bank.”

Looking back, A.R. wishes that she had more education on proper check usage and that the credit union did a better job of clarifying when her checks had fully cleared, which might have prevented this closure from happening. At the time, A.R. was unemployed and unable to pay back the negative account balance without sacrificing her basic needs. Once she became employed, the first thing she did was save to pay the credit union back because she wanted a clean record.

Now, A.R. does not want a bank account, at least for the near future, because of everything that can go wrong. Simultaneously, she recognizes that banking is essential in today’s day and age, “especially now during the pandemic... and especially now that some places are going paperless.”

In the last example of unfairness, accountholders who make no missteps at all can be saddled with a ChexSystems record due to bank error. Smart Money Coaching client, R.S., had his account closed due to suspected fraud after a bank error. Ironically, this ‘suspected fraud’ label technically fits, because though he was completely absolved, the bank at one point incorrectly believed he had committed fraud. This inaccuracy is particularly galling because a label of suspected fraud implies the presence of criminal activity, whereas banks do only limited (if any) due diligence to investigate and confirm the suspected fraud before reporting it to ChexSystems. R.S.’s story is notable and unique only because he was able to resolve his ChexSystems record with the assistance of a financial coach and OFE staff.
R.S. was a loyal customer of his bank for more than 40 years. One day, he walked into his local branch to send a routine wire transfer to his adopted children in Ghana and discovered his account was closed: “How I first found out was I went in to do a wire transfer. The teller recognized me, and we started to do the transfer and she said I’m sorry, [R.S.], but your account has been closed.”

R.S. received no communication ahead of the closure and the teller was unable to tell him why the account was closed. She told him there were no notes in their internal system. After two months of advocacy by R.S., his financial coach, and OFE staff, a bank manager called R.S. to tell him that the bank would remove this incident from his ChexSystems record. It wasn’t until an additional month later that bank staff told OFE that the account closure was because of a misapplied automatic deposit from a state agency outside of California, meaning the state agency accidentally sent funds to the wrong person and tried to reach back into the account to remove the funds. R.S. was completely unaware of and uninvolved with the issue.

After reaching out to branch staff many times in the span of two months, R.S.’s greatest qualm was that branch staff were uninterested in hearing his side of the story or telling him what happened. Instead, he was immediately reported to ChexSystems. “I should be worth more than that to the bank. I really feel violated and couldn’t sleep at night. I was a victim, too.”

R.S. says he hopes regulations will change so that banks allow a grace period for customers to contest an account closure. “If they want to suspend the account that’s one thing, but where’s the due process here?” he said. “This is not right, and the system is broken.”

Unequal Treatment – Similar activity results in different labels and outcomes

Unlike the three national credit reporting agencies (Equifax, Transunion, and Experian) which use relatively standard definitions for credit issued, monthly payments and debt in delinquency, ChexSystems lacks clear definitions for “suspected fraud” and “account abuse.” The system offers limited guidance for how financial institutions should delineate between the two when categorizing the reason for an involuntary account closure, though interviews with stakeholders, including ChexSystems itself, indicated that the difference arises based on the accountholder’s motivations and intentionality. This lack of clarity provides banking institutions and even individual bank branches with nearly unfettered discretion in how to define and apply these terms, leading to opaque internal practices and industry-wide inconsistencies.

For example, through interviews, OFE found that similar or even identical customer banking activity can be categorized in different ways, depending
on the financial institution involved. In the stories below, two clients unknowingly deposited bad checks and withdrew the funds before the checks cleared. Both were victims of fraud. However, one incident was labeled suspected fraud and the other was labeled account abuse. This inconsistency is particularly troubling given that closures for suspected fraud have harsher implications than those for account abuse.

Without clear definitions, institutions may use irrelevant proxies, such as debt owed to the institution, rather than the type of activity or motivation behind the activity to delineate between suspected fraud and account abuse. One financial coach with over ten years’ experience in the financial services industry noted that, in their experience, once a client’s debt to a financial institution exceeds approximately $400 the account closure is typically labelled as suspected fraud rather than account abuse.

OFE’s limited review of clients’ ChexSystems records corroborates this coach’s experience. Nine of the 11 clients flagged for account abuse owed debt of $400 or less and all 11 owed debt under $600. In contrast, in accounts flagged for suspected fraud, five out of the seven owed debt greater than $400. There is no reason that the determination of suspected fraud should hinge on the dollar value of the transaction. An individual could owe $4,000 to a bank or credit union in good faith if they were the victim of fraud or could purposefully and intentionally defraud a bank of $40. Using a debt threshold to define suspected fraud is fundamentally inaccurate and will necessarily result in inconsistent and unequal results.

Offering Safe, Overdraft-Free Accounts Should Eliminate Need to Use ChexSystems

In addition to this unclear, unfair and unequal treatment, there are certain situations where ChexSystems is simply unnecessary. Financial institutions assert that they use ChexSystems and other account screening agencies in order to mitigate risk of fraud and loss. However, many banks and credit unions currently offer Bank On certified accounts that meet national standards for safety and affordability. These accounts are overdraft-free, meaning that they limit the occurrence of any negative balances. This not only protects account holders from overdraft fees but also protects financial institutions from financial losses. Financial institutions should not be creating unnecessary barriers where their own financial risk has already been hugely mitigated, if not eliminated.

Ambiguous Impact of Inquiries

Aside from involuntary account closures, ChexSystems also collects and reports on inquiries. This inquiry information is purportedly neutral but appears to be used at times to deny clients’ accounts. As noted above, ChexSystems records consumer inquiries for demand-deposit bank accounts (DDAs) at traditional financial institutions as well as inquiries for loan products, like payday, installment, or auto title loans from fringe financial services (non DDAs). Inquiries reflect interest in and applications for financial products not actual use of these products. Many consumers shop
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R.A. was denied an account with a local credit union because of inquiries into installment and payday loans. R.A. made over 15 inquiries during December and January, a time in which many low-income clients like R.A. experience extra financial hardship due to holiday spending. Her financial coach said, “[R.A. has] no other negative entries on her report, yet a credit union rejected her checking account application and said it was due to her ChexSystems report.” This account denial came as a surprise to both R.A. and her financial coach because OFE has worked with many local banks and credit unions to understand their specific ChexSystems policies, but none indicated that inquiries play a role in application decisions. Nevertheless, these inquiries had an adverse effect on R.A.’s checking account application.

Given the prevalence of fringe financial products, even limited account denials due to inquiries can have significant impacts. Nationwide 12 million people take out payday loans each year, and of the ChexSystems reports reviewed by OFE, over 50 percent had at least one inquiry, meaning they could be at risk for an account denial. Aside from the inherent irrelevance, denials based on inquiries are particularly pernicious because they create a vicious cycle with consumers who are denied bank accounts due to inquiries driven further from the financial mainstream and forced to rely more on fringe financial products.

Impossible Resolution

Once a client has an involuntary account closure on their record, it is essentially impossible to successfully dispute and clear this record due to the structure of the system. There are two ways in which a consumer can theoretically resolve a negative ChexSystems record and re-enter the financial mainstream: by disputing their ChexSystems record or by paying back debt owed to the former financial institution (though the latter is generally only available for account abuse and not suspected fraud). However, even experienced and savvy financial coaches struggle to dispute clients’ ChexSystems records due to a general lack of information and the information and power asymmetries between the accountholders and the bank. Moreover, while paying back debt can work to resolve records in some instances, banks have inconsistent and unpublished policies regarding what a client must do to access
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a bank account after an involuntary account closure, leading to confusion.

Virtually impossible to resolve a record via dispute process

ChexSystems theoretically offers a dispute process where consumers can "submit a dispute directly to the source of the information" (the bank or credit union) or ChexSystems can "contact the source on your behalf to initiate an investigation." However, the automatic and immediate nature of account closures as well as information asymmetries makes it difficult, if not impossible, for consumers and even financial coaches to successfully dispute a record for account closures. Once a financial institution has closed an account, clients immediately lose access to their banking records and history, including crucial information such as their bank account number. Even if consumers have sufficient details to request more information about the closure, financial institutions are not required to provide any details about the activities that led to the closure, leaving accountholders to guess the rationale. And even if clients know exactly which transactions to dispute, they still face an uphill climb as the burden is on them to prove a negative: the lack of suspected fraud or account abuse.

OFE’s research and experience with financial coaching underscores the difficulty of disputing these records. Of the ChexSystems reports reviewed by OFE, none offered details for why the account was closed beyond the closure category. Even veteran financial coaches struggle to get information, let alone relevant documentation, from banks when following up on a client’s record. One coach noted that if he needs details, he typically sets up a meeting with a bank’s senior executive to ensure he gets some information, a practice that is neither scalable nor sustainable.

The dispute process is so time-consuming and unlikely to succeed that coaches typically set up clients with alternative products, such as prepaid cards, while tackling a dispute. Despite working extensively on ChexSystems for over a year, OFE and its financial coaching program have only successfully disputed and wiped clear one client’s ChexSystems record (R.S., the client wrongfully accused of suspected fraud). The resolution process took a total of two months and was only successful after Treasurer’s Office staff reached out to bank leadership. After witnessing the challenges faced by professional financial coaches in this process, it is nearly impossible to imagine a consumer successfully disputing a record on their own.

Limited details on how to resolve records and reopen accounts via repayment

Aside from disputes, consumers can sometimes resolve a ChexSystems record and re-open an account by paying off existing debts, but this process is variable and not publicized. While banks rarely if ever offer accounts to people with ChexSystems records for suspected fraud, many banks do offer options for people with account closures due to account abuse, typically under the condition that they first repay their debt. However, banks provide essentially no public details on how to bank with a ChexSystems record, and policies vary widely bank-to-bank, meaning consumers are unaware of this option. This lack of information is even more pronounced for low-income customers, people of color and immigrants who may struggle to navigate the banking system even without the burden of a ChexSystems record.

To create a non-dispute driven resolution process for clients with ChexSystems records, OFE surveyed banks and credit unions that participate in our local Bank On program regarding their ChexSystems procedures, including their policies for banking people with prior ChexSystems records. These financial institutions, which included multi-national banks, regional banks, and credit unions, all offered a process for clients with account abuse records to open an account, but their requirements for repayment varied widely. For example, while some institutions require a client to repay debt regardless of the amount or where it is owed, another required repayment only if the debt was owed to the institution itself or if it was above a certain dollar threshold. Notably, only one institution, Mechanics Bank, provided a second chance account for clients with records for suspected fraud so long as they submit a letter from a local financial coach demonstrating efforts to change their behavior. This account has been a lifeline for OFE’s clients.
The following table outlines what each of our local Bank On partners require for a consumer to open a bank account with an account abuse or suspect fraud record (if allowed) (financial institutions’ identities are anonymized based on their request).

<table>
<thead>
<tr>
<th>Bank On Financial Institution Partner</th>
<th>Action Required to Open an Account with Account Abuse Record</th>
<th>Action Required to Open an Account with Suspected Fraud Record</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Institution A</td>
<td>Pay outstanding balance owed to any financial institution</td>
<td>Pay outstanding balances owed to any financial institution and provide letter from local financial coaching or financial education non-profit</td>
</tr>
<tr>
<td>Financial Institution B</td>
<td>Pay outstanding balances of $500 or more owed to any financial institution</td>
<td>Not permitted to open an account until record clears</td>
</tr>
<tr>
<td>Financial Institution C</td>
<td>Pay any outstanding balances, if owed to Financial Institution C</td>
<td>Not permitted to open an account until record clears</td>
</tr>
<tr>
<td>Financial Institution D</td>
<td>Pay any outstanding balances, if owed to Financial Institution D</td>
<td>Not permitted to open an account until record clears</td>
</tr>
<tr>
<td>Financial Institution E</td>
<td>Pay any outstanding balances, if owed to Financial Institution E or if owed to another financial institution if debt is less than 12 months old; if debt is older than a year, account may be opened without repayment so long as client as less than four NSFs occurrences</td>
<td>Not permitted to open an account until record clears</td>
</tr>
</tbody>
</table>

**Individual Impacts, Systemic Exclusion**

Individually, each of the issues detailed above – lack of awareness, unequal results, impossible resolution – results in unfair outcomes for individual consumers across the City and the country. Taken together, these flaws systemically exclude the most vulnerable from the financial mainstream, particularly Black consumers and other low-income consumers of color.

The loss of a bank account and a ChexSystems record can cripple an individual’s financial capability. Without access to the financial mainstream, consumers must rely on expensive and predatory fringe financial services. One analysis found that an average family earning $25,000 per year could spend about $2,400 – almost ten percent of their income – on financial transactions, including fees for prepaid cards
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and money transfers. OFE’s financial coaching program finds that lack of a bank account prevents clients from achieving other financial goals, such as saving and building credit. For example, clients without bank accounts are unable to open a secured credit card, a proven tool to help them improve their credit.

During OFE’s research on ChexSystems, numerous clients shared how account closures and lack of a bank account impacted their lives, in small and large ways from being unable to purchase lunch at cashless restaurant to putting them at risk of becoming homeless. R.S. explains:

“These individual impacts build on one another and result in systemic and racialized exclusion with ChexSystems records disproportionately impacting Black consumers. Nationally, nearly half of Black households are either unbanked or underbanked compared with only 20 percent of white households. Data on ChexSystems records and involuntary account closure reveals a similar disproportionality. A 2008 study found that the rates of involuntary account closures were higher in counties with high African American populations as well as non-white ‘Other’ populations.

Similarly, OFE’s local data reveals disproportionate impacts. Though only 30 percent of clients served by Smart Money Coaching identify as Black, 39 percent of clients with ChexSystems identify as Black, and 47 percent of clients with an account closure on their record identify as Black. Banks and credit unions who report account closures and utilize ChexSystems to screen potential clients perpetuate these racial disparities and the resulting systemic financial exclusion. One executive at a financial institution that does not use ChexSystems or any other consumer reporting agency explained that he could not in good conscience use such systems because he viewed them as a form of modern-day redlining.

“I get my social security check [direct deposited] on the 3rd of the month and early in the morning I call my landlord to pay [my rent] by phone. I can’t wait to receive it by mail because I’m already receiving late notices.” If R.S. wasn’t able to switch his social security payments to his alternative credit union account in time after his primary bank account was closed, he believes he would’ve been at risk of eviction.
IV. RECOMMENDATIONS FOR REFORM

OFE’s local research found serious shortcomings with ChexSystems’ design and implementation and expanded our understanding of the devastating impacts ChexSystems records can have on the San Francisco’s most vulnerable consumers. Given how embedded ChexSystems and other consumer reporting agencies are in bank and credit union practices, it is important that reform be system-wide and focus on upstream drivers that perpetuate exclusion, such as the pernicious effect of overdrafts on financially vulnerable accountholders. While an ideal solution would be for financial institutions to stop using ChexSystems entirely and replace the system with a fairer, more transparent, and more responsive fraud screening process, this is unlikely to happen soon. However, in the short-term, there are numerous reforms that different actors can make to improve system operations, reduce bias, and improve outcomes. Recommendations are outlined for (1) ChexSystems and financial institutions (2) regulators and researchers and (3) financial coaching programs.

Recommendations for ChexSystems and financial institutions

Working in partnership, ChexSystems and financial institutions could take simple and concrete steps to improve system design and operation and accountholder experience. Many of these changes would bring ChexSystems more in line with other credit reporting agencies by mandating clearer policies and procedures, adequate notice, and a simpler resolution process. Recommendations include:

- Eliminate the use of ChexSystems and other account screening consumer reporting agencies for customers opening Bank On certified or other safe/non-overdraft checking or savings accounts
- Eliminate inquiries for non-demand deposit accounts from ChexSystems reports, and both clarify and enforce the neutrality of demand deposit account inquiry records
- Create policies and procedures to prevent negative ChexSystems entries based on overdrafts and good faith mistakes
- Freeze accounts flagged for negative activity instead of closing them automatically to allow sufficient time for client notice and further investigation prior to account closure
- Provide detailed information about the cause of the involuntary account closure to customers and in the report to ChexSystems
- Improve dispute resolution by providing consumers with a comprehensible, detailed consumer report and creating a clear, commonsense resolution process
- Re-examine the five-year timeframe for an incident to remain on a consumer’s report
> Offer mainstream banking solutions to clients with negative ChexSystems records and make these offerings public to consumers and financial coaching providers

**Recommendations for regulators and researchers**

There are also numerous opportunities for regulators and researchers to investigate and improve ChexSystems operations, even without direct regulatory authority over the system. These include:

> Establish clear, uniform and evidence-based policies and definitions for bank and credit unions to use in identifying and reporting on all banking history, and especially fraud and misuse

> Require greater transparency into financial institutions’ use of ChexSystems, including requiring public disclosure of policies and defined terms

> Gather and analyze data on the impacts of ChexSystems on both a national and localized (zip-code-level) scale, including number and demographics of consumers affected, and any disproportionate effects by race, ethnicity, income and geography

> Investigate linkages between financial institutions’ overdraft practices and ChexSystems records

> Increase oversight and guidance on appropriate overdraft and consumer education policies to reduce the pipeline of consumers entering ChexSystems due to good faith mistakes

> Research and report on other consumer reporting agencies, such as Early Warning Services, that are even less well understood than ChexSystems

> Pursue policies that improve access to real-time ChexSystems reports for financial coaches and consumers

**Recommendations for financial coaches**

Lastly there are steps that financial coaching providers and organizations focused on financial empowerment and capability can make today to help engage and serve consumers with ChexSystems records and get them connected back to the financial mainstream, including:

> Encourage clients to maintain banking records on an ongoing basis as a best practice

> Ensure that financial coaches know about ChexSystems, pull a ChexSystems report for every unbanked client, and provide clients with information about the implications of a record and ways to avoid future records

> Survey local banking institutions to determine their policies around account openings for consumers with ChexSystems records and develop partnerships to create a local resolution pathway for consumers with ChexSystems records to re-open accounts

> Investigate banking options that do not rely on ChexSystems, such as prepaid card providers, financial technology companies and other non-traditional financial institutions

> Educate local stakeholders on issues around ChexSystems and its exclusionary impact and join advocacy efforts to reform the system

OFE’s research and this report shows that many clients are aware of the benefits of bank accounts, were previously banked, and yet are now locked out of the financial mainstream due to ChexSystems records as well as other systemic barriers to banking. These barriers disproportionately burden consumers of color, particularly Black consumers in San Francisco. As the Bank On movement matures and Bank On San Francisco celebrates almost fifteen years since it was first launched, it is crucial that the program evolve to meet the demands of the moment. OFE is committed to raising awareness about systemic barriers to banking and reforming the system to remove these barriers and prevent new ones from being erected. Addressing these issues head on is necessary to achieve Bank On San Francisco’s goal of universal account access where all San Franciscans have a safe and affordable bank account and the opportunity to thrive financially.


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