FINANCIAL SERVICES ISSUES: A CONSUMER'S PERSPECTIVE

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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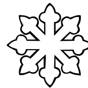

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FINANCIAL SERVICES ISSUES: A CONSUMER'S PERSPECTIVE

Wednesday, September 15, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:03 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Castle, Kelly, Gillmor, Ryun, Biggert, Toomey, Capito, Tiberi, Kennedy, Feeney, Hensarling, Brown-Waite, Sanders, Maloney, Sherman, Meeks, Moore, Ross, Davis, Baca, and Bell.

Chairman BACHUS. [Presiding.] The Committee on Financial Services, Financial Institutions, has come to order.

Mr. Castle is recognized.

Mr. CASTLE. Thank you, Chairman Bachus. I thank you very much for holding this hearing, which covers a panoply of subjects of interest to all of us.

Now more than ever we live in a world that has become increasingly complicated when it comes to personal financial matters. A generation ago, a basic knowledge of balancing a checkbook and maintaining a savings account was adequate.

However, in today's complex world, many Americans are faced with difficult decisions, such as determining what type of loan they need, whether to invest in stocks or bonds, how to best manage credit, and how soon to start planning for family education needs and their retirement.

There are approximately 40,000 different credit card products available—an intimidating thought to the most educated consumer. Unfortunately, large numbers of consumers never learn the basics of maintaining their personal finances and may struggle unnecessarily with choices leading to financial freedom.

Today, our nation's youth are bombarded with a multitude of financial options at an increasingly young age. Yet many are ill equipped to make informed decisions about financial matters.

According to a 2001 Teenage Research Unlimited survey, teenagers spend, rather than save, 98 percent of their money—a total of $172 billion in 2002.

Various public and private organizations have developed programs to promote public knowledge of basic finances. Many of these organizations are working with elementary and secondary

students to provide them with a strong education in money management and provide teacher training on how they can integrate basic financial education principles in the curriculum.

For example, in my home State of Delaware, MBNA opened a financial advisory service, FAS, over 10 years ago which offers professional advice to MB&A people and their immediate family members.

Since the service was established, MBNA has extended the service into the community and into the local school systems to the facilitation of basic credit and money management curriculums to all grade levels in elementary, high schools and colleges throughout the country.

FAS has educated nearly 1,500 students in Delaware, 14,000 students throughout the country since 1995.

I think all of the organizations offering financial literacy programs to our communities should be applauded.

Although some consumers view the large number of credit options to be daunting, the strong national credit system in the United States has been a driving force. It has helped sustain our economy in recent years.

That system is supported by the Fair Credit Reporting Act, which this committee reauthorized last year, and ensures that factual information is available on which to base the extension of credit, employment or insurance.

Virtually every business in this nation and every consumer who has ever used credit depends on this system. Without this strong national system, consumers would pay higher costs for credit.

Educating consumers and enabling individuals to understand all of their financial options and opportunities is a daunting task. The review by the subcommittee today will help us better understand how consumers in the financial services industry can have a more symbiotic relationship.

Mr. Chairman, I do thank you for holding this hearing today, and I look forward to hearing from each of our witnesses.

I yield back the balance of my time.

[The prepared statement of Hon. Michael N. Castle can be found on page 53 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Sherman, we welcome you to the hearing. Would you like to make an opening statement?

Mr. SHERMAN. I would, unless the chairman would like to give one first.

Chairman BACHUS. I will let you proceed and then I will reserve mine.

Mr. SHERMAN. Okay.

Mr. Chairman, thank you for holding these hearings. We need to take a balanced approach toward protecting consumers on the one hand and allowing access to credit on the other.

We could, as a national policy, say, we are not going to allow anybody to pay any more for credit than those who have the very best credit records. The effect would be to deny the opportunity to borrow to most people who really need it.

At the other extreme, we could lift all the standards, lift all the rules and allow consumers to live in a world where their State leg-

islatures cannot protect them and this Congress refuses to do so as well.

In evaluating the credit opportunities facing consumers, there is sometimes a tendency to express everything as an annual percentage rate, which makes sense if one is borrowing thousands of dollars for months or years. But when I go to use the ATM machine, I found the bank where I only pay $1, and I withdraw $40.

I think that is a good deal in one respect, and that is, there are many times in my life when having $40 is worth a dollar. I don't need government to tell me that I am paying 20,000 percent interest, or infinity percent interest, to get my own money and therefore should be denied the opportunity to get $40 when I need it.

Likewise, we have payday lenders—and there are a lot of reasons to provide some significant regulations in that area. But to express everything as a percentage ignores the real human circumstance where your car is in the shop and you cannot get it out unless you give the mechanic $300.

Now, we can always tell people, "Go rent a car for the next two weeks and that way we will protect you from a $40 charge or a $20 charge or whatever," or we can recognize that sometimes a charge by a bank or a financial institution of $10 or $20 or $30 or $40 needs to be looked at as a charge rather than as an annual percentage rate, whether it is convenience or whether it is bailing somebody out of a jam.

This Bush administration has done worse than zero in protecting consumers. If they just did nothing, well, okay.

But instead, we have the OCC—and I may have to leave these hearings for a bit, Mr. Chairman, to go speak on the floor on this; I know that we have an amendment coming up on the floor—decides that Congress should be irrelevant, State legislatures should be irrelevant, and we should strip away all State protections, and we should do so not by congressional action but by runaway regulators, and we should do this only for national banks.

So what we are saying is: Those lenders who choose not to be national banks, "You don't live in a free market economy; you live in a tilted economy where different rules apply, depending upon where you get your charter."

We are turning to bank regulators and saying, "It is time to compete. Throw the doors open."

The state regulators and the federal regulators should be in a race to the bottom to try to get hand-out charters and get business in an entrepreneurial spirit to capture financial institution market share.

We are turning to Congress and saying, "We don't need you. We will just do it at the administration level." And we are, of course, turning to consumers and saying, "Not only will the federal government do nothing, we will make sure the States do nothing to protect you as well."

And then finally, I believe we have—what?—maybe eight or nine people that is the complaint department at the OCC for the entire country, because you are going to call for the firing of all State consumer protectors since they won't be able to do anything with regard to national banks.

This regulation is absolutely absurd. It is an attack on democracy and an attack on consumers.

Likewise, the decision of this administration, who without congressional involvement tell banks that "it is not enough that you have Gramm-Leach-Bliley, we are going to going to give you something extra and not go through Congress" is also an attack on consumers.

So I look forward to protecting consumers, to having national standards where we need them, and to make sure that whatever national standards or preemptions are called for are decided through a legislative process, balanced process.

And I thank the chairman.

Chairman BACHUS. Thank you, Mr. Sherman.

At this time I will give my opening statement.

I want to welcome our panelists.

This hearing supplements the numerous hearings that this committee has held over the past 2 years, hearings which in many instances have focused on how we can improve the regulation of our financial services markets for the benefit of consumers.

For example, consumer benefits with a focus of our extensive hearings on the Fair Credit Reporting Act last year, you will recall President Bush proposed and signed into law the Fair and Accurate Credit Transactions Act of 2003, historic legislation to ensure that citizens are treated fairly when they apply for credit.

Consumers will now have a right to receive their credit reports free of charge every year as part of a national financial literacy campaign.

In addition, the legislation creates important new tools to address the growing problem of identify theft by establishing a nationwide fraud alert system.

On our committee, Mr. LaTourette and Shadegg have, along with Ms. Biggert and Ms. Kelly and Ms. Moore and Ms. Hooley, played I think a very important role in this.

But I commend the Treasury Department and the administration as well as this committee for that fine work on that legislation.

Also, I think what some people have said is one of the most important consumer pieces of legislation was signed into law by President Bush on June 27th, 2003, when he—well, actually he helped to launch the do-not-call registry with the chairman of the Federal Trade Commission and the Federal Communications Commission. Over 54 million phone numbers have been registered on the national list, protecting millions of Americans from most unwanted telephone solicitations.

And I would say to anyone listening now: If you have not called, you can call 1-888-382-1222. And there is also a Web site: www.donotcall.gov.

Also, legislation has recently been signed—although it has been tied up in the court by some civil libertarians—protecting consumers from unsolicited commercial e-mail, including nonsolicited pornography and other offensive matters. I think the Bush administration is working through the courts to try to enact that.

Also, I think an important thing that this committee and also the administration has done is to work very hard to promote financial

education. I know Mr. Ney, on our subcommittee, has promoted this in the sub-crime lending area.

I mentioned I thank Congresswomen Biggert and Kelly in their important work in this area.

Other legislation, achieving the American dream of owning a home, important legislation where approximately 40,000 low-to moderate-income families per year will be able to purchase their first home. And in doing so, they will strengthen America's housing market and every community in which those homes are located.

The average assistant grant will be $5,000 per family, with the down payment and closing costs. A member of this committee, Ms. Katherine Harris, or Congressman Katherine Harris of Florida, was the main sponsor of that.

There are also several other programs.

But let me just depart by that to say in general in the minute that I have remaining that consumers in America—in reviewing fair credit reporting, we found out we have more choices as Americans than people in any other country for credit. More credit is available to us. And those that have enjoyed, over the last 20 years, the greatest increase and access to credit have been minorities and low-income citizens.

The growth in home ownership and credit extension to our minorities is truly amazing in this country. Where countries like France have an average of three or four credit card choices, we have over 1,000.

That is not to say we don't have problems.

One problem that Mr. Sanders and I championed last year was efforts to end what we considered unfair practices in the bait-and-switch areas. Unfortunately, Mr. Sanders and I only garnered 22 votes in this full committee, actually, this full committee, on our legislation.

Forty-four of our colleagues, the majority of our colleagues, by far voted against this legislation. We offered a similar amendment on the floor and we only had 142 votes there; 272 of our colleagues, including a majority in both parties, voted against our legislation.

But we have regulation proposed.

And this committee did then go back and substituted an amendment, which I think was a good amendment, to address this issue, but the Senate saw fit to strip that amendment out.

I will close simply by saying that members have told me that we have a religious holiday later in the day for many of our members, and they have asked that we speed these hearings up. We expect votes on the House floor and we want to hear from our panelists.

But also, members have asked that they be allowed to make opening statements and have urged me and I think it is important that they have that opportunity.

At this time I will recognize Mr. Sanders for any opening statement he may wish to make.

[The prepared statement of Hon. Spencer Bachus can be found on page 48 in the appendix.]

Mr. SANDERS. Thank you very much, Mr. Chairman.

And as you have indicated, the issues that we are dealing with today is of enormous importance to the American people. So I thank you very much for holding this hearing.

And I thank all of our guests for being with us today.

I especially want to welcome Tamara Draut, the director of Economic Opportunity Program at DEMOS, and Jean Ann Fox from the Consumer Federation of America for being with us.

But thank you all very much.

Mr. Chairman, as a result of what I would consider to be the collapse of the middle class: the fact that we have lost many decent paying jobs, that many people are working longer hours for low wages, new jobs being created paying low wages and the jobs that are being lost, what we are seeing in our country is that consumers are now being crushed with a record-breaking $2 trillion in debt, which has more than doubled in the last decade.

A lot of folks out there are deeply in debt and under a lot of economic pressure. In fact, a record-breaking 1.6 million families went bankrupt last year alone, an increase of more than 125 percent since 1989.

And tragically, as Harvard University Professor Elizabeth Warren and others have noted, it is the children—children are more likely to suffer through their parents' bankruptcy than through a divorce.

And you made the point, Mr. Chairman, that in France those poor folks there only have four credit cards and we have 1,000. I know that, because I get those 1,000 people sending me their applications every other day.

In fact, in a given year a credit card company sent out some 5 billion—this is true—5 billion credit card solicitations, and usually targeting young people who don't know enough about financial management.

Credit card issuers made a record-breaking $7.3 billion in profits by charging excessive late fees last year. And total credit card fees have increased from $8.3 billion in 1995 to an astounding $21 billion last year, accounting for 35 percent of total credit card profits.

And, Mr. Chairman, I know that you share some of these concerns.

This is an issue we have to deal with.

The bottom line is that the American consumer is being ripped off big time by credit card companies who are charging usurious—usurious—rates.

We all know that interest rates for the last couple of years have been almost historically low. And yet you have hard-pressed families who are paying 25, 28 percent interest rate on their credit card. And this is an issue that we have to address in a multifaceted way.

The chairman correctly mentioned that he and I worked together trying to address this issue and we did not have the votes.

Mr. Chairman, you also remember that on the day we brought it forth, this place was loaded with lobbyists from banks and credit card companies putting excessive pressure on members, not only on this committee but on Congress. And that is the way it goes.

That is part of the political problem that we have in America because these guys who have huge sums of money want to make sure that Congress does not represent consumers, that we allow a process to continue by which they make excessive profits by ripping off

millions of people through outrageously high interest rates on their credit cards, and this is an issue that has to be addressed.

Let me just mention, going into a little bit of depth about what I call this bait-and-switch scam—and it is a scam. And it is a scam that this Congress should not allow to continue.

Here is the deal: Folks, you are going to get today—go to your mailbox, especially if you have a kid in college, you are likely to get a couple of these cards: zero interest rate, 2.66, guaranteed. And then three months from now, after your son or daughter fills this out or you fill it out, what you will find is you are paying 13 percent, 18 percent, 25 percent. "Well, how did that happen?"

They promised you zero interest rate. Well, read line 65. Get out your magnifying glass, read line 65 on page 18, which tells you that the big front-page story about zero interest rates is totally meaningless because they can raise rates anytime they want.

Now, some of the justification that they use for raising interest rates—we did some research and we found that 3 years ago you were late paying off a college loan, or you were late on a mortgage payment, you are now "a financial risk" and "we are raising your rates." That is one reason.

Despite the fact that every single month you paid your bill to that credit card company on time, that is irrelevant. Or they don't need any reason at all.

A fellow I know saw his interest rates jump significantly. He called up the credit card company and they said, "Oh, you caught us. We will lower your rates."

Chairman BACHUS. Thank you.

Mr. SANDERS. But, Mr. Chairman, you took a little bit of time extra. Let me have just that——

Chairman BACHUS. With unanimous consent, the gentleman——

Mr. SANDERS. Just a little bit.

This is a scandal. It is a scandal, and Congress has got to stand up to these lobbyists and these credit card companies and these banks who are ripping off the American people, because they are causing a lot of damage. The people who are hurt the most are people who go through divorces, who loose their jobs, who need to use the credit card for daily needs. And we cannot accept that.

So I would hope, Mr. Chairman, that you and I and others will have the courage to stand up to the banks and substantially lower credit card interest rates in this country.

Thank you very much.

Chairman BACHUS. I thank the gentleman.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

The title of this hearing is rather wide-ranging: Financial Services Issues, A Consumer's Perspective. Well, I happen to be a consumer, my family is consumers, some of my best friends are consumers. So I think I bring a consumer's perspective to this particular hearing.

It has been my observation over several decades of life that the best consumer protection we can have is a competitive marketplace providing a wide variety of goods and services to consumers at competitive prices.

We had many, many hearings on the extension of the Fair Credit Reporting Act, and we had testimony after testimony—which I thought was very persuasive—that in America we enjoy the widest range of financial services at the most competitive prices.

We have credit offerings today that people could only dream about decades before.

I don't know who writes these memorandums for the members, but I certainly agree that benefits generated in today's marketplace also derive from the ability of financial services providers to segregate risk and price, financial products accordingly.

Years ago, a bank may have had only one or two loan products for which a consumer either qualified or did not. And that was true decades ago. And now we have extended credit to those who previously have not had it. And what we have enjoyed?

Among other things, we have enjoyed the highest rate of home ownership in the entire history of the republic. We have seen a booming economy here recently, enjoying some of the greatest economy growth in almost 20 years, and part of that is due to access to credit.

Some people will want to say, "Okay, well, maybe we have access to a lot of different products but the cost is still too high."

Well, I don't know. To me, I see a lot of signs of a very effective marketplace. I just had my staff go to something called bankrate.com that examines different credit card offerings.

The best I can tell, Mr. Chairman, as a consumer in America, I have hundreds of credit cards I can choose from with interest rates ranging anywhere from 17.88 percent at something called Bath National Bank, and here is 8.95 percent at Simmons First National Bank and everything in between with all kinds of different terms. To me, that looks like pretty effective competition.

In addition, I come from Dallas, Texas, if you want to pull out the yellow pages and see who will compete for payday loans, there are 110 different offerings. They are about as ubiquitous as the convenience stores and 7-Elevens. To me, that seems to indicate, again, there is effective competition.

I read where 30 years ago only 2 percent of low income people had access to credit cards. Today, it is 28 percent. We have had an explosion of ATMs, credit card offerings.

All in all, I believe the American consumer is far better off today when it comes to the accessibility and the cost of credit products, than he was 30 years ago, and I believe the free enterprise system has a lot to do with it.

I did not even see the yellow light, Mr. Chairman. I am already out of time?

Chairman BACHUS. You still do have additional time.

Mr. HENSARLING. Okay, well, I just saw the red light come on.

Chairman BACHUS. Your time has been exceeded. But you are doing very good.

[Laughter.]

Mr. HENSARLING. I would just leave, if I could, Mr. Chairman, and take 30 seconds extra.

I believe if there are those in this committee who believe that somehow consumers are being wronged, I would hearken back to something our Founding Fathers wrote, Jefferson in particular,

when it came to our political democracy, and that is, “I know no safe depository of the ultimate powers of the society but the people themselves. And if we think them not enlightened enough to exercise their control with a wholesome discretion, the remedy is not to take it from them but to inform their discretion by education. We should not outlaw freedom, we should not outlaw competition; we should help educate with financial literacy the members of our society.”

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Hensarling.

Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

And I want to thank the chairman and ranking member for organizing this hearing. Too often issues of dealing with consumers are put on the back burner. And we have to make sure they are on the front burner.

But also, too often sometimes we like to pit one against the other. I want to be clear that I am not in opposition to the financial services industry. In fact, the financial services industry is very important to me and the State of New York.

Many of my constituents not only rely upon the credit that they can get through financial services, but they are employed by them. And so, therefore, I think that we need to make sure that we have a meeting of the minds and are able to work collectively to get together for the benefit of both the consumers as well as financial institutions.

But we don’t often here. I mean, when you talk about issues that Mr. Sanders talked about, and yet we don’t get the votes, and we should keeping working them, bait and switch, something is just apparently just wrong and we need to make sure.

I go by my life experiences sometimes. And to say that some of the interest rates are not usury and some people not taken advantage of, if we shut our eyes to that, then we are just dead wrong.

I can just go by just a personal experience myself, and that is, visiting my 78-year-old dad.

You know, he did not have a lot of education, et cetera, and I just happened to go to review some of his accounts. And I looked at some of the credit cards that he had. So that in many of them, he was being charged a 25 and a 26 percent interest rate, apparently because he did not even know.

So I instantly called some of these cards and they dropped them down to 9 and 8 percent. But they were doing it simply because they could do it. That is wrong. And we must stop that. And we must put that on the front burner and not ignore that.

Ultimately somebody is going to have to pay. I mean, when he does not pay the bills, then somebody is going to pay it anyway, whether it is going to be the consumer or the financial institution or some insurance company. It has to be paid.

So we might as well look at it and try to come with some best practices that is good for the consumers and the people as opposed to taking advantage. Because we cannot let people take advantage of those simply because they can.

One of the keys to this is financial literacy, particularly for the young. We must educate individuals because that is the quickest

way to put this out of business. But until we can do that, we have to act and hold accountable those in the industry to make sure that they are not taking advantage of those that are vulnerable.

Then on the other side, we have to make sure we don't throw the baby out with bath water. For example, we take payday lending. We have to make sure that those who offer payday lending, who are payday lenders, adhere to best practices of the industry and are not providing customers with multiple or rollover loans.

At the same time, we have to acknowledge the fact that many payday lenders do adhere to the rules.

And at the same time, I—again, using myself and my family as an example—can talk about times where payday lending was utilized so that my family—in particular, I could talk about one of my sisters now—could avoid excessive late payments or bouncing a check, that they understood what it was and it was with a reputable company. So we cannot eliminate the industry.

We have to work to make sure that we have people who follow the best-practice rules. I think that is the key here.

That is why this hearing is so important, because we have to balance the two, that we make sure that we don't throw the baby out with the bath water, we hold people accountable who are taking advantage of others, but then we just don't simply brand an industry bad when in fact it does offer alternative means to individuals so they can avoid late fees and excessive interest rates and bouncing checks.

And so I hope and thank the panel for being here and look forward to working closely together so that we can have a balanced argument that benefits both the consumer as well as not put individuals out of business and thereby limiting choice the consumers may have.

Thank you, and I yield back.

Chairman BACHUS. Thank you, Mr. Meeks.

At this time I recognize Ms. Biggert.

I would like to commend Ms. Biggert for your work on financial literacy, which some of the members have noted.

Mrs. BIGGERT. Thank you very much, Mr. Chairman. And thank you for holding this hearing today, which does cover a broad range of financial services issues.

But this morning I would like briefly to highlight the progress that our country has made in one specific consumer protection initiative, financial literacy, which has been mentioned several times, but I think it is so important.

Chairman BACHUS. What I am saying they mentioned is your work——

Mrs. BIGGERT. Oh, thank you, thank you very much.

The House Financial Services Committee and Congress and our federal agencies and private-sector advocates I think have made great strides toward achieving our goal to help Americans, especially young Americans, become literate in finance so that they can make informed decisions about their financial future.

In December 2003, as part of the Fair and Accurate Credit Transactions Act, Congress authorized the Financial Literacy and Education Commission, FLEC. The commission has taken an important step recently by asking the public for its input on the de-

velopment of a national strategy. And I would urge my colleagues to consider providing their thoughts as the commission's efforts to develop a national strategy will be a key focus of the federal government's efforts in this area.

So I think that the commission would benefit from the views of the members of Congress as it designs the national strategy.

Secondly, financial literacy is certainly a lifelong process, which ideally begins in grade school with a solid foundation in economics. And the importance of K through 12 economics as the cornerstone of a lifelong financial literacy program is one of the reasons why I support the Excellence of Economic Education program, the EEE program that will develop competitive grants for innovative success-oriented programs that deliver economics to our schools.

If our schools don't teach the ABCs of finance and economics, our children are likely to fall into that behind in life, especially in today's global competitive economy.

And thirdly, Congress continues to take an active role in ensuring that our citizens of all ages and walks of life have access to objective financial education.

Just last week in the Subcommittee on Capital Markets, Insurance and Government-Sponsored Enterprises, we held a hearing entitled: GI Finances, Protecting Those Who Protect Us. And during this hearing it was revealed that our military may not be as objectively educated as they could be about finance.

So since our military personnel often have unique financial needs and opportunities, perhaps this is a new opportunity for us to examine how both the public and private sectors can effectively coordinate to help educate our service men and women about financial services.

And then I might note, Mr. Lively, in your written testimony you mentioned your organization's commitment to financial literacy and your involvement in FLEC. I want to thank you for your dedication to our cause and encourage you, as well as the other witnesses, to expound on your recent efforts with FLEC and provide your ideas to them as they develop a national strategy for financial literacy.

So thank you very much.

And thank you, Mr. Chairman. I yield back.

Chairman BACHUS. Thank you, Ms. Biggert.

Mr. Ross?

Mr. ROSS. Thank you, Mr. Chairman.

And I cannot think of a more appropriate time to be holding this hearing than this time in our nation's history. I was a little surprised when I heard one of those who spoke earlier and before me today talk about this robust economy. In the country I live in, we have 9 million people out of work. We have lost a million jobs to China. We have 44 million people without health insurance and one in five children living in poverty.

We have the largest budget deficit ever in our nation's history for the second year in a row. Our government today is spending $900,000 more than is taken in every 60 seconds.

And because of this, Mr. Chairman, we are seeing more and more people who need financial help. And that is why I believe this hearing is so timely today.

I want to thank you, Mr. Chairman, and Ranking Member Sanders for having this important hearing to discuss various consumer perspectives about products and practices within the financial services industry.

With the increase in competition and innovation that has occurred in the marketplace, the American consumer is able to obtain a variety of products suited to their needs. I am concerned that existing federal law has not kept pace with the speed of the marketplace. I encourage this committee to continue its review of these laws and update them when necessary.

I urge the consumer groups to work with industry to ensure that those who utilize credit products receive adequate protection while having access to these services.

Again, thank you for convening this hearing, and I look forward to the testimony of our witnesses in continuing to work with the interested parties on these important issues.

I cut my statement short in deference to time, Mr. Chairman, but I would like to submit the entire statement for the record.

[The prepared statement of Hon. Mike Ross can be found on page 57 in the appendix.]

Chairman BACHUS. I thank you.

Mr. Ross, if you would permit me, you mentioned the unemployment rate and the job growth. And I simply point out to you—I think maybe there is a misconception—the unemployment right now is 5.4 percent. During the 1990s, it averaged 5.8 percent. During the 1980s it averaged 7 percent. And that was sort of skewed somewhat by the last year of the Jimmy Carter administration when it reached unbelievable heights, and that sort of skews the whole 1980s.

During the 1970s it was 6 percent.

So actually they are basically at 30-year lows.

And as for job growth, this year—you talked about this year—from January to July, the job growth is 62.1 percent.

During the Clinton administration the first time, it was 60 percent, the second time it was 63.

So it actually is growing faster than that mean.

And I know for every person out of work it is a tragedy. But I think that there is some debate there. I know now is not the time to do that.

I would like to recognize at this time Mr. Feeney—oh, I am sorry, I apologize. I did not know you had a response.

Mr. ROSS. Absolutely, Mr. Chairman. And if it was not such a serious matter it would be funny.

Chairman BACHUS. We can for the record, because I don't want to do this to you, I will introduce my things from the Department of Labor and vice versa.

Mr. ROSS. You want to talk numbers that say that the unemployment rate is down compared to the 1990s, you know, I can talk numbers about the worst job growth record since Herbert Hoover. All these things mean one thing: Consumers need credit and they need access to credit where there are consumer protections and safeguards in place.

We can talk statistics all day long, Mr. Chairman. What I am concerned about is real working families.

I was with a lady in her 50s, a woman who is in her 50s, in Queen, Arkansas, just a week ago who that day lost her job, a job she had held for 25 years. What complicates it even more is that she was told that she could keep her health care for $800 a month under a COBRA plan. Her unemployment benefits won't even be $800 a month.

These are serious times. These are difficult times for a lot of working families all across America. And I would hope that we could work in a bipartisan way, not by pointing to this number or that number, but work to truly try to restore this economy and put people back to work.

Unfortunately until that happens, we need to make sure that our consumers are well protected when it comes to being able to acquire the money they need to put clothes on the backs of their children and feed their families, and oftentimes in my district simply be able to afford their manufactured home payment.

These are tough times. And I hope this hearing today will go a long way toward providing the kind of protections that our consumers need when they go to the bank or utilize a credit card or a payday loan.

And with that, Mr. Chairman, I thank you.

Chairman BACHUS. I thank you. I think working in a bipartisan way is always the best way.

At this time I would like to recognize Mr. Feeney for an opening statement.

Mr. FEENEY. Well, thank you, Mr. Chairman. I appreciate the hearing. Access to credit for all Americans is important.

One of the concerns I have is that at the State level in Florida—and I know some 30-some other States have dealt with the issue surrounding payday lending. These are sort of unusual loans that fill a niche that traditional lenders are not interested in.

And I hope we do as we did in Florida, which is to take a rational approach to this so that we don't, as the gentleman said earlier, throw the baby out with the bath water.

There are a lot of do-gooders in the media and elsewhere that would like to make sure that every American, regardless of creditworthiness or access to assets for security for a loan, has low-interest loans, and that would be a very ideal situation. But very few of them are interested in investing their own capital to make those low-interest loans, people that have no assets and no creditworthiness.

The fact of the matter is that there are alternatives to people that do not have access to credit who have very little assets or no assets and do not have established credit. Some of them are not pleasant—going to a loan shark and going to a skylark over time was something traditionally done in the streets of America. Others are even less pleasant perhaps—selling drugs or prostitution, other illegal activities. You have to make that week's rent payment.

Appropriate regulations, like usury laws, are something that I fully support. I think a lot of the responsible states have done the right thing. But they have recognized that if there was a huge windfall profit in this area of lending money to people with little or no assets and little or no creditworthiness, that the way free markets deal with that is for people that see the problem to invest

their own capital in it and go out and make those low-interest loans to people that cannot get traditional loans at traditional lenders.

So I hope we will approach the payday issue as responsible States like Florida have done in the past.

Chairman BACHUS. Thank you.

Mr. Baca?

Mr. BACA. Thank you very much, Mr. Chairman, for hosting this hearing that I feel is very important as we look at protecting our consumers in terms of credit.

I would like to state a little bit in reference to—as we look at the unemployment. I know that you have touched base, and I want to retaliate a little bit in response.

Because when we look at 9 million people unemployed right now and we look at the average salary being at $9,000 less than we—and we have done more of the outsourcing, that is why, in terms of technology, credit reporting and everything else is so important, because a lot of the work really is going outsourcing.

So it is important to know the new technology, the new knowledge, and protection of individuals and consumers is very important, and that is what people should know.

And then the majority of the jobs, when you look at those jobs that are created, it is not new jobs that are created; it is people that are doing two or three or four different jobs and we are counting twice the number, too, as well, and that is why the numbers seem to be high when in reality they are a little bit lower.

But we can debate that even further in reference to that.

But all in this area, I think it is important because we need to protect our consumers.

Today, consumers confront a host of modern technologies such as electronic banking, remittance, electronic payments that no one dreamed of just 10 years ago. But the law has not kept pace. Consumer protection may be too outdated to protect against consumer abuse.

And we need to make sure that our consumers have trust, faith and change their attitudes and behavior of how we deal today with technology in banking. And that is part of the education, the literacy, that needs to go on.

But people have to have faith and trust. Once we develop that kind of faith and the trust and the literacy that goes on and the technology—and changing attitudes, because amongst the elderly, it is always so hard to change their attitude. “I like the way we did banking in the past.” When we change it, it is like, “Do we really have trust in it?”

So we must ensure that consumers have proper information, that they are not subject to bait-and-switch tactics, that they are not defrauded and that their funds and nest eggs are protected from criminal and scam artists.

We must ensure that the consumers are safe and that they enjoy the best access they can to properly give them to our banking system.

I thank the witnesses for coming today and I look forward to asking them questions later on, too, as well.

And thank you very much for having this hearing today.

Chairman BACHUS. Thank you, Mr. Baca.

At this time I recognize the gentleman from Pennsylvania, Mr. Toomey.

Mr. TOOMEY. Thank you, Mr. Chairman. And I just, too, briefly want to commend you and the ranking member for holding this hearing. I think this is a useful exercise.

I hope we are going to hear about how and why the United States financial services industry has simply become by far and away that industry which provides the most extensive, most efficient, most widespread availability of credit to its population in the entire world. There is no other country that is close.

And it has been a big part of why our economy has outperformed the rest of the world, why our standard of living is the highest in the world, and why our prospects for a strong economic growth continue to be terrific.

I hope we will also talk about how and why it is that the best consumer protection out there is the marketplace, is the fact that consumers have a choice, is the fact that there is a competitive industry in all aspects of providing credit, and therefore every player in that industry has to be concerned about losing customers and therefore providing the best possible services for that customer. That is how our economy works, that is how this industry works.

I hope that we can avoid the greatest danger to the continued growth and availability of credit, which would be excessive and inappropriate regulation coming out of Washington.

So I hope we are going to learn more about these things today.

I want to thank you for holding this hearing, Mr. Chairman.

Chairman BACHUS. I thank the gentleman.

Mr. Davis from Alabama?

Mr. DAVIS. Thank you, Mr. Chairman. And given our time constraints, I will be brief.

Let me just make two separate points.

The first one, I want to make sure I give the Chair of this subcommittee an enormous amount of credit. One of the things that makes this committee I think unique among a lot of the standing committees in the House is that we have a real capacity to occasionally get things done on this committee. We have a real capacity to occasionally find a common ground, as I sit here somewhere near the middle of this room, we have the capacity to make things happen on this committee.

I was enormously impressed by the work of my friend and my colleague from Alabama, who is the Chair today, of a work that he did in leading us to a bipartisan, effective Fair Credit Reporting Act last year.

When I came to this institution in early 2003, some very strong mindset that fair credit reporting would go the way of bankruptcy reform, an idea that a lot of us would embrace but that there would be significant partisan backbite around the issue.

There has been the mindset that, well, it will clear the House, would not go anywhere in the Senate.

One of the reasons that we have passed that legislation, the signing of the law by the president about a year ago, is because of the leadership we share on this subcommittee.

And that capacity to get something done across the aisle is a mindset that I hope we bring to this set of issues.

Make no mistake, it is very easy for us to talk about these things in theory. It is very easy for us to talk about these things in the abstract. The reality is that, particularly for those of us on this side of the aisle, a lot of our constituents are unbanked, a lot of our constituents are outside the reach and the protection of the conventional financial services industry.

And we can do one or two things with those folks: We can be so concerned about them in theory that we don't help them in practice, or we can sit back and condone practices that are occasionally abusive.

You know, we have to find the middle ground I think between those two things.

The realities of these final weeks, so we are not going to get much done at any level. But I am hoping that when we come back here in January, the 109th Congress, that we will have a real ability to steer toward the kind of middle ground on payday lending, on the small lending practices that will begin to address the real gaps we have in this country.

One final point: One of the most amazing statistics in America today is the wealth gap between African Americans and Caucasians. The average assets, when you subtract out the debt, for an African American family is less than $20,000. It is over $120,000 for Caucasians. That is a 6 to 1 gap that is not based on any law that we can change tomorrow, it is not based on the old kind of segregation or discriminatory practices, but it is ingrained in our society. We have to combat it. And I have the mindset that maybe this committee can be a part of that process.

I yield back the balance of my time.

Chairman BACHUS. I thank the gentleman. I appreciate those kind words.

Mr. Davis is a Harvard graduate. I am beginning to like Harvard more and more.

[Laughter.]

At this time, I would like to—are there any other members that have an opening statement?

If not, we will proceed to the introduction of the panel.

Testifying today will be Michael McEneney, a partner in the Washington, DC, office of the law firm of Sidley Austin Brown and Wood. His practice focuses primarily on regulatory and legislative issues impacting financial institutions with special emphasis on consumer issues. He is a frequent speaker and writer on financial services issues and has testified before Congress on behalf of a number of financial services organizations.

We welcome Mr. McEneney.

And actually he is representing the Consumer Banking Association here today.

We will also hear from Mr. Randy Lively, president and CEO of the American Financial Services Association. That is a Boston-based trade association representing market-funding financial services firms that provide credit to consumers and small businesses.

His extensive background includes 22 years with Sears Roebuck. He also, in 1981, joined Zale Corporation, a national retail jewelry

chain based in Irving, Texas. He is a graduate of LSU and is on the board of trustees for the National Foundation for Consumer Credit advisory board for Georgetown University.

We welcome you.

Our third panelist is Ms. Jean Fox, director of consumer protection for the CFA. Ms. Fox is an advocate for consumer protection for the Consumer Federation of America, a nonprofit association of 300 consumer groups established in 1968 to advance the consumer industry research, education and advocacy. She specializes in financial services, electronic commerce and consumer protection issues.

She is the co-author of many reports and articles on payday lending. I won't go through—it is a long list.

She is also a co-author of a series of annual reports on refund anticipation loans. And I know that some of our members have expressed a particular interest in that—a very extensive and long background.

I think Mr. Sanders particularly requested that we have your testimony because he has talked about refund anticipation loans on many occasions.

Our third panelist is Ms. Tamara Draut. She is the director of economic opportunity program for A Network for Ideas and Action, New York, New York. Is that correct?

Ms. DRAUT. Demos.

Chairman BACHUS. Okay, Demos, A Network For Ideas and Action, thank you.

They manage the development and execution of all research related to economic security issues, including research on credit card debt trends, a principal investigator for a national household survey research project to study the nature and scope of credit card debt among low-and moderate-income households.

And she has authored several reports and publications including "The Growth of Debt Among Young Americans," something this committee has concerns about, "The Growth of Debt Among Older Americans" and several other publications.

She is a graduate of the Columbia University School of International and Public Affairs and Ohio University EW Scripps School of Journalism.

We welcome all four of our witnesses.

At this time we will start with Mr. Lively. We will go from my left to right.

Welcome, you all.

STATEMENT OF RANDY LIVELY, PRESIDENT AND CEO, AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. LIVELY. Mr. Chairman, Representative Sanders and members of the subcommittee, I am Randy Lively, president and chief executive officer of the American Financial Services Association.

AFSA is a national trade association whose 300 member companies include consumer and commercial finance companies, captive auto finance companies, credit card issuers, mortgage lenders and other financial services firms that lend to consumers and small businesses.

I thank you, Mr. Chairman, for conducting this hearing, given the importance of consumers' credit in driving our economy.

As of July 2004, outstanding consumer credit was over $2 trillion, according to seasonally adjusted figures from the Federal Reserve. Census Bureau figures for the second quarter of 2004 show a homeownership rate of 69.2 percent, meaning there are more homeowners in America than at any time in history.

Credit availability also enables people to buy vehicles that transport them to work, pay for education and training that qualifies them for jobs and to start or expand small businesses.

AFSA members are proud of their role in helping create advancement opportunities for many Americans and sustaining growth for our nation's economy. As you know, we supported the committee's successful effort that led to last year's enactment of the Fair and Accurate Credit Transactions Act.

We thank you for your leadership, Mr. Chairman, in crafting balanced legislation that preserves our nation's consumer credit system.

The FACT Act assures uniformity in our national credit-granting system and maintains creditors' ability to offer a variety of products and services to meet borrowers' financial needs.

In recent weeks, the subject of consumer credit has emerged on another front with the announcement of the Kerry-Edwards plan to protect Americans from abusive financial deals. A fact sheet on this plan says that Senators Kerry and Edwards are committed to ensuring that responsible consumers continue to gain access to credit and that companies must be responsible and must play fair.

AFSA agrees with both of these objectives, but when it comes to the plan's recommendations on how to reduce lending abuse, we have an entirely different point of view.

In the short time I have today, I would like to touch upon two things that we are doing in this area.

The first is our members' code of ethics which includes voluntary standards in a number of areas, such as mortgage lending, arbitration agreements and the collection of past-due accounts. AFSA and its members believe the interest of the public can be well served by conducting business in a way which builds and fosters public trust and confidence in the industry. Each AFSA member is expected to review our code and establish and enforce their own policies to carry out the letter and the spirit of these standards.

The second thing to mention is our long-time involvement in consumer education initiatives for both adults and youth.

The AFSA Education Foundation is a founding partner of the Jump$tart Coalition for Personal Financial Literacy, whose nearly 140 partners include government agencies, associations, educational institutions and consumer organizations all working together to improve financial understanding in grades K through 12 and on into college.

As the chairman of the Jump$tart Coalition, I am very proud of its accomplishments and its success in drawing attention to the need for youth financial education in this country.

Our other major education initiative is MoneySKILL, a free, online personal finance curriculum from the AFSA Education Foundation that is aimed at the millions of high school students who

graduate each year without understanding credit use, budgeting, retirement, or other money management basics.

To date, teachers in 45 states as well as in Canada, Guam, China, Germany, Malaysia, New Zealand and South Africa have registered to use the program.

We continue to explore opportunities to reach more students with MoneySKILL, including possible partnerships that will allow the curriculum to become available to higher-risk youth.

MoneySKILL consists of 34 modules that students complete in about 40 minutes each. Within the course's general content areas—which include income, expenses, assets, liabilities and risk management—students receive unbiased information on a number of fundamentals. These include the effect of income taxes on take-home pay, understanding interest when borrowing, using credit cards responsibly, how buying a car compares with leasing one, and understanding different types of insurance and the costs and benefits of borrowing, to name a few.

Mr. Chairman, we certainly appreciate and welcome Senators Kerry and Edwards' interest in reducing abusive lending, a practice that has long been condemned by the association and its members. And we agree that the industry should take a leadership role in addressing the problems, which is in part why we are involved in programs like MoneySKILL and coalitions like Jump$tart.

At the same time, we are concerned about the impact of these plans on the functioning of the consumer credit market. When limits are placed on a creditor's ability to use performance-based pricing, responsible consumers who pay their bills on time inevitably bear the burden of higher costs generated by those who fail to properly manage their use of debt.

As noted by Federal Reserve Board Chairman Alan Greenspan, credit-scoring technologies have served as the foundation for the development of our national markets for consumer and mortgage credit, allowing lenders to build highly diversified loan portfolios that substantially mitigate credit risk.

Over the past 80 years, the U.S. financial services system has evolved into the most efficient in the world and one that serves more of its population than any other.

Proposals to tinker with the underpinning of this system should not be taken lightly.

The good news is that we already have laws in existence to get at the unscrupulous lenders who are defrauding people, and we ought to do everything possible to enforce those laws to their fullest extent.

Ultimately, however, the most effective way to deal with both excessive use of consumer debt and abusive lending is through education.

Chairman BACHUS. Thank you.

Mr. Lively, if you could wrap up.

Mr. LIVELY. Yes, sir.

Chairman BACHUS. Is that a convenient point?

Mr. LIVELY. It is.

Correct choices by the consumers represent the behavioral solutions to many of the problems that are being discussed. We believe equipping people with the knowledge to make decisions that benefit

them, and avoid those that don't, will greatly improve their financial situations while making our economy even stronger.

Thank you very much for the opportunity.

[The prepared statement of Randy Lively can be found on page 103 in the appendix.]

Chairman BACHUS. Thank you.

Mr. McEneney, we welcome you to the committee.

STATEMENT OF MICHAEL F. MCENENEY, PARTNER, SIDLEY AUSTIN BROWN & WOOD LLP, ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION

Mr. MCENENEY. Thank you very much, Mr. Chairman.

Chairman Bachus, Ranking Member Sanders and members of the Subcommittee, my name is Michael McEneney, and I am a partner in the law firm of Sidley Austin Brown and Wood.

It is my pleasure to appear before you this morning on behalf of the Consumer Bankers Association

Today's hearing is focused on financial products and services from the consumer's perspective. There is no doubt that today's financial marketplace looks quite good from the consumer's perspective.

The financial services marketplace offers consumers a wider variety of financial products and services than ever before. Not only can consumers choose from a wide range of products, but they can obtain them over the phone, using the Internet, or through personal interaction at the financial institutions' offices.

Our financial marketplace is truly a success story. However, the success did not develop overnight or by accident. In fact, it was not too long ago when retail banking services looked much different than they do today.

Back then many people had to carry cash or checks at all times because credit cards as we know them did not exist. And to get that cash, people had to spend time going to the bank branch and standing in line for a teller because there was no such thing as an ATM.

Visiting the bank branch in person was also necessary to get a loan, and in many instances you had to have an account with the bank to get that loan. The approval process could last for weeks, and fewer people qualified for loans than would qualify today.

There are obviously a number of reasons for the spectacular evolution of the financial services industry and the ever-expanding choices available to consumers. However, I believe that most of these reasons relate to providing financial institutions with the flexibility to compete fiercely with one another to provide a better product to consumers at lower costs.

I would like to use a few examples to illustrate my point.

First, the process by which consumers obtain home mortgages has been simplified and made more efficient through increased competition in the marketplace. Today, consumers benefit from lenders across the country competing with one another to provide consumers with home loan opportunities wherever they may reside. Decisions are often made almost instantaneously, and lenders are able to offer loans that meet a variety of consumer needs.

Given the number of lenders and types of mortgages available, creditworthy borrowers are likely to have several choices when choosing how to finance their homeownership.

Second, I think we may take for granted that a consumer today can obtain a credit card that suits his or her individual needs. The credit card may offer frequent flyer miles, the logo of the consumer's charity, or a rebate on purchases made with the credit card.

The consumer can also shop for low interest rates and cards that do not have any annual fees. There once was a time when annual fees were common and consumers obtained few ancillary benefits for using the cards.

Today, most people can find an offer for a card without an annual fee or for a card that offers benefits simply by reading their mail.

Third, the ability of financial institutions to price their products in a more precise manner has resulted in enormous benefits for all consumers.

Thanks to our national credit reporting systems, successful lenders are able to use the increasing amounts of information available to them to evaluate and manage risk that allows them to lower the cost of credit to those consumers that have good credit history.

But consumers with good histories are not the only ones who benefit.

Now, instead of a bank offering a one-size-fits-all loan product to only those consumers with above-average credit histories, the bank can use risk-based pricing to offer more consumers access to credit at a variety of risk-based prices. That means more home mortgages, more college education loans and more auto loans for safe transportation for consumers of all walks of life, not just the wealthy or those with perfect credit histories.

Competition in the market place also means an expanding pie where those who have been traditionally underserved can enter the mainstream of our economy.

CBA's members continue to develop and expand product offerings to satisfy the demands of an increasingly diverse market. This includes efforts to bank the so-called unbanked through use of payroll cards, stored value products and remittance services in addition to offering low-cost traditional banking products, such as checking accounts. For example, CBA is hosting a Hispanic banking forum later this month to highlight bank activities in this area and provide an opportunity for banks to share their knowledge and experience.

Mr. Chairman, current law ensures that consumers receive valuable disclosures with respect to financial products. But it is also important to note that our financial marketplace is a complex system that relies on providing consumers with choice.

Disclosure laws are important, but they can only do so much in the absence of fundamental financial literacy on the part of consumers.

Banks have long understood this point, and that is why banks have been in the forefront of efforts to expand financial education.

In April 2004, in fact, CBA published a survey regarding the progress made in the financial literacy of consumers as a result of

banks' educational efforts. The results of the survey evidence an increase in banks that participate in consumer financial literacy education.

In fact, of those banks that responded, a full 100 percent of the institutions participate in at least one of the eight areas of concentration.

Although the entire survey can be found at www.cbanet.org, I would to be able to submit a copy of the survey for the record.

In conclusion, Mr. Chairman, I would like to assure you that CBA's members are committed to ensuring that consumers receive the information they need, including three information disclosures and financial education materials and opportunities.

Thank you again for inviting me to appear before you today. I would be pleased to answer any questions.

[The prepared statement of Michael F. McEneney can be found on page 109 in the appendix.]

Mr. TIBERI. [Presiding.] Thank you, sir. Thanks for your testimony.

Ms. Fox?

STATEMENT OF JEAN ANN FOX, DIRECTOR OF CONSUMER PROTECTION, CONSUMER FEDERATION OF AMERICA

Ms. FOX. Representative Tiberi, Ranking Member Sanders and members of the committee, I am Jean Ann Fox, director of consumer protection for Consumer Federation of America.

I am testifying today also on behalf of Consumers Union, the Center for Responsible Lending, the National Consumer Law Center, on behalf of their low-income clients, and the U.S. Public Industry Search Group. The National Community Reinvestment Coalition has asked to join our comments as well.

We thank you for holding this hearing to look into financial services from a consumer perspective. And I have to tell you, from our perspective, the financial marketplace looks quite different than you have heard so far this morning.

The trends that we are seeing include explosive growth of quick-cash credit products offered at exorbitant interest rates and under unfair terms, including payday loans, bounced-check loans, which banks call courtesy overdrafts, tax refund loans and other financial products.

Besides seeing an explosive growth in high-cost, quick-cash credit being marketed to consumers, we have also noted that there is targeting of cash-strapped and credit-constrained consumers—minorities, members of the military and the working poor—for these high-cost financial services.

And we also note the misuse of bank powers to undercut state authority to regulate the credit market and protect consumers at the State level.

Besides developments in the credit market, we also have a lot of developments in the financial services market, with electronic products coming on the market without upgrading the consumer protections that should apply to these new ways of carrying and spending money so that consumers can have confidence in things such as payroll cards or pre-paid debit cards, other forms of electronic

money. The rules have not kept up with the developments in the market, and we urge your attention to that issue.

I would like to speak briefly about a few of the high-cost credit products that we have concentrated on in the last few years. But I am interested in answering your questions on any other aspect of our testimony.

Payday lending has been mentioned by several of you. This is a very big market. There are $40 billion in loans made per year. Consumers are paying about $6 billion to borrow money in $300-or-so increments, paying $15 to $30 per $100 for loans that are due and payable in full on their next payday, or the check that they have left behind with the payday lender will bounce, setting off another cascade of financial problems.

These are small loans subject to state small-loan regulation and covered by federal credit law, including Truth in Lending, according to the Federal Reserve and a series of court decisions.

We have noted that competition does not effectively protect consumers at this end of the market. If competition did discipline prices, consumers in Chicago would be paying the lowest rates for payday loans rather than the highest—typically 520 percent annual interest for loans in Illinois.

We also note that the payday loan industry best-practices do not adequately regulate this product. The trade association best practices say nothing about the cost of the loans. They don't prevent repeat borrowing, which is one of the serious problems with this product. For example, in Iowa the average payday-loan customer at a single lender will have over 12 loans per year, which is a continuous borrowing experience, not an occasional quick-cash transaction.

States have dealt with payday lending in a variety of ways. There are 33 states that have authorized it, two where it is not prevented by state law, 15 states where it is currently not legal.

The industry has not been content to stick to the States where they have legal authorization to make their loans. These companies have partnered with banks located in states without usury limits and claim the right to make payday loans in states where it is not authorized, such as in North Carolina or New York or Georgia.

The Georgia legislature took action this year to stop that practice. They enacted an anti-rent-a-bank payday loan law signed by Governor Perdue, that has been upheld so far in federal court challenges.

But payday lenders also partner with banks to do business in ways that exceed the limits of states where the state law makes it legal to do payday lending. For example, in Texas, the rules under the Texas Finance Commission allow payday lending, but under terms that are covered by the state's small-loan law. So almost all of the payday lending in Texas is done through rent-a-bank arrangements at much higher rates than Texas rules allow.

The same problem exists in New York, North Carolina, Pennsylvania and Michigan.

We have not come before you to ask you to outlaw payday lending. We think that is an issue at the State level, although we do think Congress should be concerned that financial institutions are

encouraging consumers to write checks without money in the bank, and are doing that through FDIC-insured banks.

But we do urge your immediate attention to the problem of rent-a-bank payday lending. The FDIC is the only federal regulator that allows banks under its supervision to partner with storefront lenders to undercut the ability of states to enforce their laws, and we ask your attention to that problem.

We are also concerned about the explosive growth in "courtesy overdraft" bank bounce loans, a product which we believe is the bankers' response to how much money the payday lenders are making by encouraging people to write checks without money in the bank.

And this is not your old-fashioned overdraft protection that you apply for and have to be creditworthy to get and get a contract that the bank will in fact cover any of your checks that overdraw your account. These are "courtesy" programs where the banks advertise that it is okay to write a check without money in the bank but do not promise to cover those overdrafts. Banks charge their penalty fee as if you have done something wrong rather than something they have given you permission to do.

And besides covering the checks, these bounce loans also apply when you put your ATM card in to withdraw cash and you are allowed to withdraw more money than you have on deposit without being given a warning of that, asked for your permission, or given any disclosures on what those cash advances are going to cost.

We conducted a poll this summer to ask consumers what they think about key features of bank bounced-check loans, and 68 percent of them said that they think it is unfair for banks to permit overdrafts without their affirmative consent. An even greater majority, 82 percent, said that it is unfair for banks to permit overdrafts at the ATM without notice or warning on the screen about asking for their consent to advance the funds and impose a fee.

We have urged the Federal Reserve to modify their proposed rules in order to address some of the fundamental problems with bounced-check loans, but we do note for your consideration that if that is not done, that we need Congress to change explicitly Truth in Lending so it is clear that cash advances done at the ATM and by banks that give you permission to overdraw your bank account is credit that deserves the Truth in Lending disclosures that every other form of lender has to abide by.

We also note there has been a big growth in the refund anticipation loan market. This is another form of quick-cash loan to consumers who are having trouble making ends meet. This is a bank loan based on your tax return so that you get money in a day or two rather than waiting a couple of weeks for the IRS to direct deposit your tax refund into your own bank account, which is available to consumers for free.

Consumers paid $1.14 billion in loan fees and an additional $406 million in filing fees in 2002 to get quick-cash loans based on their tax refunds. And again, banks are partnering with tax-prep firms in order to export their home state deregulated interest rate so that a state like Massachusetts that has a small loan interest rate cap has difficulty enforcing that in this situation.

Chairman BACHUS. [Presiding.] Ms. Fox, if you could wrap up. We appreciate your testimony.

Ms. FOX. Thank you, and I will be glad to answer questions on any of these other subjects.

On the question of the credit card universal default, we think that that should be prohibited. There are so many reasons why a consumer's credit score could change that have nothing to do with whether they are paying their bills on time. It is just fundamentally unfair to change a consumer's interest rate at one lender because of a change in their credit score of their experience with another lender. We appreciate your concern about that matter.

And I would be glad to answer your questions, and thank you for the opportunity.

[The prepared statement of Jean Ann Fox can be found on page 77 in the appendix.]

Chairman BACHUS. Thank you.

Ms. Draut?

STATEMENT OF TAMARA DRAUT, DIRECTOR, ECONOMIC OPPORTUNITY PROGRAM, DEMOS: A NETWORK FOR IDEAS AND ACTION

Ms. DRAUT. Good morning, Chairman Bachus, Ranking Member Sanders and members of the committee. I want to thank you for holding this hearing and asking Demos to participate.

As noted, Demos, which takes its name from the Greek word for people, is a national public policy organization. We are nonpartisan and nonprofit, based in New York.

As director of the Economic Opportunity Program, I oversee the organization's research and policy efforts on issues related to economic security.

Demos began studying the growth of debt out of our overall interest in the economic well-being of working families. I very briefly want to share with you one or two key findings about the growth of credit card debt from our research.

Our research shows that credit card debt has grown most rapidly among three segments of the population: older Americans, young adults and the middle class.

Between 1992 and 2001, credit card debt among those aged 65 to 69, presumably the newly retired, rose 217 percent to an average balance of nearly $6,000. Older Americans are now in more credit card debt than the average household.

Young adults' credit card debt more than doubled over the same time period. And middle-income families saw an increase in their credit card debt of 75 percent.

I want to be clear from the outset that Demos believes the availability of credit is beneficial to households. Using revolving credit to pay off large, unexpected expenses, like car repairs, allows families to spread payments over time, providing less disruption to the family budget.

Using credit to supplement a family's income during a job loss can help ensure the family stays afloat and devote precious income to maintaining the mortgage, rent, or keeping the lights on.

However, beneficial access to credit becomes all too destructive due to widespread, abusive and capricious industry practices.

I would like to focus the rest of my testimony on three of these practices, all of which ensure many households never get a fair chance to pay down their debt.

I also want to say from the outset that we fully support risk-based pricing, the practice of charging less creditworthy customers more for their credit. I do not think the following policies fit this criteria.

As Ranking Member Sanders and Chairman Bachus both mentioned briefly, I want to just touch as well on bait-and-switch or universal default practices in which credit card companies routinely raise the interest rate on a card holder for being late with another creditor.

The resulting rate increase is often double the original rate and typically ranges from 24.99 APR to 30 percent. Demos believes this practice unduly punishes many responsible debtors.

The second practice I would like to talk about is the treatment and definition of late payments. All the major issuers now consider a payment to be late if it arrives after 1 or 2 p.m. on the due date, even if, as they say, the check is in the mail. This zero tolerance policy also penalizes responsible debtors.

A run-of-the-mill tardy payment now results in a late fee that averages $31 and a rate increase that is typically double or even triple the original APR—again, these penalty APRs range from 24.99 percent to 30 percent.

I want to underscore that these rates are being paid by cardholders who are not typically considered delinquent or in default. They may be 1 minute, 1 hour or 1 day late on a payment. And yet they are paying the same penalty rates that they would pay if they were behind by a month or more.

Finally, I want to draw attention to the retroactive application of penalty rates.

Whether a rate increase results from a run-of-the-mill tardy payment or is due to bait-and-switch practices, this new rate is applied to all of the cardholder's existing balances.

By applying the higher rate to previous purchases means that credit card companies are essentially changing the terms retroactively on consumers and in essence raising the price of every item or every service purchased previously with the card.

We believe this is a violation of the account terms on which the cardholder and company agreed upon and which issuers should be held accountable.

These severe default rates levied on customers who are paying their bills in good faith, if not always in perfect time, constitute an enormous and undue increase in the cost and length of debt repayment.

Indebted families need protection from these punitive rate hikes and penalties. We urge Congress to consider the following actions: One, to limit interest rate increases to future purchases only; two, to prohibit bait-and-switch practices; three, we support limiting the amount a cardholder's rate can be raised to an amount no higher than 50 percent of the original rate. For example, if the original APR is 9 percent, the rate can only be raised to 13.5 percent.

Finally, we believe it is imperative that a late payment grace period of three to five days is allowed to ensure that responsible debtors are not unduly penalized.

While other reforms are certainly necessary, we believe these modest protections would help give families a fair chance to pay down their debt and get back on the path to savings and financial stability.

I appreciate your time today and will be happy to answer any questions.

[The prepared statement of Tamara Draut can be found on page 58 in the appendix.]

Chairman BACHUS. Thank you.

That concludes our panelists' testimony.

I am going to reserve my questions at this time.

Mr. Sanders?

Mr. SANDERS. Thank you, Mr. Chairman.

This has been a very interesting hearing. The testimony has also been illuminating.

I think Mr. Lively mentioned his concerns about Kerry's proposal. Raising that issue reminds me a little bit of what Senator Edwards calls the two Americas. And that is what we are hearing today, two Americas.

We have heard from some of our Republican friends that the economy has never been so good, that financial services are providing all of these opportunities, we have the highest standard of living in the world—everything is just rosy, peachy.

And then we hear from other people who are talking about the decline of good paying jobs, the growing gap between the rich and the poor, the increase in poverty, the fact that 45 million Americans have no health insurance, that people who are desperate are borrowing money at exorbitant interest rates.

So let me start off by asking my friends from the banking community here, let me just ask you—you will excuse me, maybe being a little personal here, but let me ask you a question about morality.

Somebody works hard, they lose their jobs. We have lost close to 2.7 million manufacturing jobs in the last few years. It happens everyday to somebody. They borrow money. They have to go to their credit card to pay their mortgage or their rent or their kids' student loans. And then out of nowhere, for no particular reason, having paid their credit card loans to the company on time, every month, their rates go up from 9 percent to 25 percent. That happens in America today.

Do you think that is moral, Mr. Lively? Do you think that is moral behavior, something that we should be proud of?

Mr. LIVELY. I don't think what we are talking about here—I don't know that I can discuss this in the context of morality. I think what we are talking about here is creditors are taking risk in the marketplace. They are the ones whose money is at——

Mr. SANDERS. If you lend me money and I pay you back on time every month, and you double my interest rates for any reason that you want, and I have lost my job and I need to borrow money—I am asking you a question, a personal question.

We hear a lot about morality in America. Is that a moral act, in your judgment? Should that be something that we should condone?

Should the people of America condone when somebody gets divorced or loses their job, having to pay twice the interest rates that they originally agreed to, when they paid their bill every single month? Have you ever thought of the morality of that?

Mr. LIVELY. You know, I just don't think I can go to the question of morality in a financial——

Chairman BACHUS. What if you just substituted the word "ethical business practice" in a——

Mr. SANDERS. I mean, you can ask that question, a good question.

Chairman BACHUS. I was trying to assist you.

Mr. SANDERS. No, no, no, no, because I think—you know, what we hear more and more, there are some people out there talking good versus evil, "I am moral, you are not moral."

I think the way we behave publicly has something to do with morality. There is Biblical phraseology dealing with usurious rates.

Let me rephrase it: Is it usury when a rich person today can go to the bank and borrow money at 4.5 percent and a working person pays 28 percent? Is that usury in your judgment?

Mr. LIVELY. No, sir, it is not usury in my judgment. It is the function of risk-relationships applying to the cost of the services that are being provided.

Mr. SANDERS. It is not usury.

Mr. McHenry, is that usury in your judgment?

Mr. MCENENEY. McEneney.

Mr. SANDERS. I am sorry.

Mr. MCENENEY. Well, actually, if I could, I would like to comment on both questions.

Mr. SANDERS. Start with usury, because I am interested in that one.

Mr. MCENENEY. Well, actually, it is not usury, quite clearly.

Mr. SANDERS. Charging 28 percent is not usury when the prime rate is 4.5 percent?

Mr. MCENENEY. Well, I think it has to be taken in that broader context that you asked the question of morality. I am one of those people who thinks that all people, including businesses like banks, should conduct themselves ethically and with a moral basis.

One of the ways that banks do that is by making credit available to people of all economic walks of life, to people across the economic spectrum——

Mr. SANDERS. We don't have a lot of time, I apologize.

Mr. MCENENEY. And I think——

Mr. SANDERS. But you did not answer my question. My question is that you lend me money, I pay you back every month on time. I fulfilled my end of the deal and you double or triple my interest rates. Do you think that is ethical?

Mr. MCENENEY. Well, what happens is—what we are talking about is risk-based practices.

Mr. SANDERS. No, no, you are putting the term on it. I am saying I pay you back every single month on time. I fulfilled my end. You have doubled or tripled my interest rates. Is that ethical?

Mr. MCENENEY. The circumstances under which I am aware that that happens is quite ethical——

Mr. SANDERS. Okay, thank you, thank you. Let me go to Ms. Fox. We don't have a lot of time.

Ms. Fox, is it ethical if I pay back my loan to you every single month and you double or triple my interest rate?

Ms. FOX. No, it is not ethical. No, I don't believe that is ethical and it is not good public policy, and it has an unintended consequence of putting consumers in a position where they are less likely to be able to repay everyone else, and it puts consumers in a downward spiral of unaffordable debt.

Mr. SANDERS. Ms. Draut, do you think it is ethical that some people borrow money at 4.5 percent, and working people who have fulfilled their end of the bargain, paying off what they are supposed to pay off every month, on time, are paying 15 or 20 percent? Do you think that is ethical or good practices?

Ms. DRAUT. Absolutely not.

And I would like to add that this is not about a difference in creditworthiness; this is about a difference in need and use of credit. And working families need and use credit more often, and as a result are paying a much higher price than their wealthier counterpart.

Mr. SANDERS. Ms. Draut, do you have any figures as to how many millions of people today are using their credit cards to buy food or to take care of basic necessities?

Ms. DRAUT. Well, unfortunately there is very little data out there about why people go into debt, how long they stay in debt and what they are using their credit cards for.

I can tell you that I would hope to be able to answer your question in about four months from now when we complete our own household survey asking those very questions.

I will tell you that in interviewing hundreds of people through my research at Demos, credit cards have become a Band-Aid for the family budget. When somebody loses a job, when there is an unexpected expense, the credit card makes up the slack. It could be groceries, it can be car repairs.

But most of the people we talk to are going into credit card debt to cover the mundane, everyday basics of life, not to get a luxury vacation or designer sneakers or new jewelry.

Mr. SANDERS. Thank you very much.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Sanders.

Ms. Biggert?

Mrs. BIGGERT. Thank you very much, Mr. Chairman.

My first question is for Mr. Lively: How important is financial literacy to improving consumer experiences in the financial services marketplace?

Mr. LIVELY. In the scheme of things, financial literacy is one of the greatest challenges we have as a society in dealing with the complexities of our marketplace. And if we are successful in achieving an improved level of understanding of how to manage money in today's marketplace on the part of our majority of our citizens, everyone will benefit from that.

Mrs. BIGGERT. Then, Mr. McEneney, from what we have heard there certainly is a marketplace for products such as the payday

lending and refund anticipation loans. Would regulating these products reduce consumer choices?

Second of all, should we focus our efforts on educating the American consumer so that they, not the government, can choose whether or not to engage in such transactions?

Mr. MCENENEY. Well, first of all, there is no question that if price were regulated, that is, if the fees were limited for these products, that many consumers buy and provide a convenience, many consumers find are extremely important when they have an emergency need for cash.

There is no question that if you regulate fees, then those services and loans are going to go away to a significant extent, particularly for lower-and moderate-income families. That is obviously an impact that nobody wants.

They are regulated, though, in terms of disclosures. For example, refund anticipation loans are subject to the Truth in Lending Act and consumers are provided disclosures up front. But after receiving those disclosures, the consumers decide that they really do want the loan.

And in fact, refund anticipation loans are quite popular with a lot of consumers. I think the numbers I saw were something in the neighborhood of 60 percent of refund anticipation loan customers are repeat customers.

Now, having said all that, all these folks get disclosures. The key is helping them understand what those disclosures mean and also understanding how to conduct their financial lives in a way so that they don't get into trouble. And that really goes to financial literacy.

The importance of that issue I think is reflected in the fact that organizations like CBA and its members are devoting enormous resources to try and to get out there and really help people understand how to manage their finances. Because after all, the folks who manage their finances well make the best customers, including for banks.

Mrs. BIGGERT. Well, we have seen that very few families are actually saving money, or saving it for a rainy day, when they have problems. Would a financial literacy education help that?

Mr. MCENENEY. Absolutely.

Mrs. BIGGERT. Will they know how much money to put away?

Mr. MCENENEY. Absolutely. You know, one of the keys is helping people understand how much money is coming into the household, how much money goes out for basic expenses, how much money they have left to save and how much money they can really afford to borrow.

I think all creditors would agree that consumers that understand how to manage their debt in a way so that they only borrow the amount that they can actually repay is better for everyone. It is the sort of fundamental cornerstone of successful lending. People have to pay you back, and the more education you can do in terms of ensuring that people don't get in over their heads, the better off you are.

Mrs. BIGGERT. Thank you.

Mr. Lively, Ms. Draut's testimony I think paints a pretty bleak picture with respect to credit card debt. Do you have any comment on that? Is that the way the marketplace is really reacting?

Mr. LIVELY. Actually, the vast majority of American consumers manage their debt quite well. The problem is that in the last 25 years, we have brought into the marketplace, through the advances in technology, the capacity to understand through scoring algorithms how to price for risk.

We are now extending credit to a whole new generation of people who were not there 20 years ago. And many of these people also grew up during the period of time when we stopped basically preparing people with life skills to go into the marketplace.

And the consequence of that is twofold: One, we have a lot of folks who now have access to credit who are less skilled in managing the process.

And so as time goes on, we are going to catch up with the power curve we got behind through the advances in technology.

It is unfortunate that we have these issues. But at the same time, these issues are growing out of a hugely successful economic system that continues to grow and embrace more and more citizens.

Mrs. BIGGERT. Thank you, thank you very much.

I yield back, Mr. Chairman.

Chairman BACHUS. Thank you.

Mr. Sherman?

Mr. SHERMAN. Thank you. I have a lot of comments, and then I promise a question at the end.

This idea of a financial literacy—wonderful thing. But it is like the Band-Aid, like, "Let's engage in all the unfair practices possible, protect us from all State regulation, and don't worry about it because we will send out pamphlets to people that will tell them not to buy the unfair products that we are selling."

The idea that the average consumer is managing their credit well means that many consumers are in debt $5,000, $10,000, $15,000 at 15, 20, 25 percent interest, but as long as they don't default so the banks gets the 15 or 25 percent interest, that is managing their credit well.

The fact is that the average American family does not have any savings at all or very little for retirement, and many, many are paying outrageous interest rates month after month.

Let me endanger my own re-election by criticizing my bosses, namely the people I represent, and reflect on one thing and that is, we do have consumers making bad decisions because we live in a have-it-now, spend-it-now, a nonsaving-oriented culture.

And financial literacy may be a part of that answer, but a change in the culture to one more akin to Japan or Europe, where people save for retirement and they can tap upon that savings for a rainy day, sure beats a situation where you max out your credit cards in ordinary life and you need a payday loan when a crisis comes up.

I realize that is difficult to say because we in Congress make more money and should have less difficulty running our financial lives than many of our constituents.

As to sub-prime loans, which we have talked about very little here, we are in this bizarre circumstance where if you are a na-

tional bank, you have no regulation whatsoever. I am surprised the whole country is not up in arms over that. But if you are not a national bank, then the lender is subject to perhaps thousands of different regulations, and if they make even one mistake in one city regulation, they get subject to some big class action lawsuit.

Clearly, we would benefit by having a set of national standards that is not a lowest common denominator, and I think—and this is not just a home state thing—should be patterned after the California standards that are working quite well if it was not for the OCC screwing them up by lifting them off the—by causing half the lenders in the state not to be subject to them.

So I look forward to this committee taking a look at some prime lending with the idea of making sure that all consumers in the country get basic protections, good protections, even if they cannot be everything that some of our panelists would suggest. That is a much better alternative to having half the lenders totally exempt from state regs and other half of the citizens of the country living in states with inadequate state regulation.

I would like now to turn to Mr. Lively.

I have a bill. The bill says if there is a national disaster and the president declares it, and often postal service is out, that if you are late, by just a length of the national disaster, in paying your bill, which you typically pay by mail, that you don't get hit with a late penalty.

And basically your organization, as much as any, is the reason that bill is not going anywhere. And it occurs to me that maybe you could look in the camera—because there are people in hotel rooms right now in northern Mississippi, northern Alabama, they have just fled the hurricane. Maybe they don't have anything better to do than to watch C-SPAN.

And maybe you can tell them why you think that unless they happen to have some brother-in-law who's a lawyer who can get on the phone and yell with one of your service representatives, why the average person fleeing this hurricane is going to get hit with late charges and why you are here to defend that as a national practice.

Mr. LIVELY. Virtually every one of the companies who provide services in the marketplace have specific policies to deal with the kind of national——

Mr. SHERMAN. And you know, sir, what those policies are. If you are smart enough and savvy enough and you tell it to the right person and you use just the right words, then they will lift it. But if you are an ordinary consumer, bang, use the hurricane in order to impose penalties.

Why are you opposed to simply having a statute that says, "no penalty for people who are mailing their checks from an area of a national disaster for the length of time of that presidentially declared national disaster"?

Mr. LIVELY. We have a program in the education foundation of AFSA that provides consumers with information on how to interface with their creditors in the event of one of these kinds of disasters.

Mr. SHERMAN. So get an MBA or get——

Mr. LIVELY. Sir, excuse me, but the companies stand tall at the end of the day because they do indeed look after their customers.

Mr. SHERMAN. The fact is, the vast majority of those people who are fleeing this hurricane are going to get hit with late penalties, they are not going to read your pamphlet, you have not given them the pamphlet, they have better things to do than to read your pamphlet. The pamphlet won't tell them exactly how to deal with each and every lender.

And lenders who are members of your organization don't want a simple computerized rule that says if you have a presidentially declared disaster, that should not be a profit center for the bank.

I yield back.

Chairman BACHUS. Thank you.

Mr. McEneney—did you want him to answer?

Mr. MCENENEY. I was just going to ask if I could comment on this whole issue of the national disaster and the late fees. I think one of the things that Mr. Lively was referring to is that there is actually a history here in the credit card industry of dealing with these sorts of issues in a way that I think meets the objectives of your bill.

For example, I know Chairman Bachus, at one point in the not too distant past, worked with folks in the credit card industry in connection with some of the mail disruptions that occurred post-9/11. What the industry did was voluntarily to go ahead and ensure that people were not imposed late——

Mr. SHERMAN. Only if you call, only if you say the right words, only if you are savvy. And why are you opposed to a national standard that will apply even if the disaster happens to a constituency whose member of Congress does not work out a special deal, because you are looking for a profit centered out of the hurricanes. Shame on you.

Chairman BACHUS. Mr. Sherman, actually they waive their fees in all cases.

Mr. SHERMAN. On a case-by-case basis.

Chairman BACHUS. No, I mean on the 9/11. The industry——

Mr. SHERMAN. When the pressure gets hot, when the member of Congress is able to shame them on a particular disaster. But the fact is, they have got no policy for this hurricane. Nobody here can say, as an automatic rule in the computer—not when you call, but in the computer—that the victims of this hurricane are not going to get hit with late charges.

Now, 9/11, under tremendous political pressure they decided 9/11 would not be a profit center.

Chairman BACHUS. I think it would be tremendously complex and the national disaster does not have a time period, for one thing.

Mr. SHERMAN. I have a bill. If we have the markup of that bill, I assure you that the practical problems will be worked out. It is a short bill. We can certainly provide—or we could just say two weeks, and that would solve this for an awful lot of people. The bill is 2549, and I am looking for co-sponsors.

Chairman BACHUS. And certainly one thing we are doing with this hearing today is bringing these things out. I welcome you pointing that out.

Mr. Toomey?

Mr. TOOMEY. Thank you, Mr. Chairman.

Just to follow up on this idea, my thought on this is: There are lots of nice things, tangentially related services, that businesses can offer their consumers, their customers, including banks, credit card providers, others. It is a very long list. And some do and some don't.

I think the question here is: who ought to drive that process. Should it be consumers making choices amongst competing firms that are offering different services—that is what you call a market economy, that is what you call economic freedom, that is what you call the system that is generated the most wealth and opportunity in the history of the world—or should we sit here and dictate it and issue fiats and say, "We don't really care what consumers prefer, we don't really care what businesses want to offer, what business model makes sense. We are simply going to demand that you provide certain set of services or benefits that we will dictate." That is really the choice.

I, for one, think that as much as possible we ought to stick with the former model, because that is the one that clearly has been much, much more successful everywhere in the world it has been tried.

As for one specific issue I would like to touch on, it has to do with this idea that is characterized in Ms. Draut's testimony as the bait-and-switch tactic. And I just have to comment and then I will have a question about this.

First of all, I was in the financial services industry for a few years in a capacity in which in some respects we extended credit in the area that I was in. I have also been a small business owner, and in that capacity I have been a borrower. So I have been receiving credit.

Now, every loan document that I ever saw, whether I was with a bank or whether I was in my restaurant business, every one that I can ever remember had a provision in there that says, "Notwithstanding whether you are current on the loan that you have either lent or borrow," as the case may be, "if you default on another obligation that you have somewhere else, then this loan," on which you are not in default—or I should say not in a payment default—″this loan will be considered to be in default as well."

And there is an obvious and simple reason for this, and that is because if somehow I have become unable to make my obligations with respect to another lender, it is pretty reasonable to assume that my creditworthiness has diminished, and that is why I am in default to this other lender, whoever he may be.

Mr. SANDERS. Would the gentleman yield?

Mr. TOOMEY. Let me finish my point. This obviously addresses something.

But I have to be very honest with you. It never ever occurred to me, on either side of this transaction as a lender or a borrower, that it was somehow unethical for a financial institution to acknowledge that my creditworthiness has changed and therefore the circumstances under which I am borrowing money has changed and therefore—in fact, in the cases that I am alluding to, it was not a question of an increase in interest rates; the lender had the

full authority to accelerate the loan and demand full repayment immediately, and if I failed to do that, I could be put into bankruptcy.

I, to this day, believe that is an extremely reasonable, perfectly ethical arrangement. It seems to me that is about evaluating risk and pricing it accordingly.

Now, you could take the view that we should not price-risk, that we should have a uniform standard, sort of socialistic model that says, "Regardless of your ability to repay, regardless of the change in your circumstances to repay, we are going to have a single uniform rate." You could do that. It would result in an extremely inefficient allocation of capital, it would result in higher prices being paid by people who are not in default, who are paying their bills, and I would not advocate that we go in that direction.

So my question is—after my question I will be happy to yield to the gentleman from Vermont—but my question is: This provision by which a rate goes up when someone is in default on another obligation, I would just like to ask you folks whether you consider that to be a matter of adjusting prices for risk.

And if you could just sort of go down the row, I would appreciate it.

Mr. MCENENEY. Yes, sir, it is.

The only circumstances in which I see the types of changes that you are talking about are clearly circumstances where you are pricing for risk, and it is also clear that it is ethical if it is done the right way.

Consumers receive disclosures, being told that this could happen. And unless those disclosures are made, it is not only unacceptable from an ethical standpoint, it is against the law.

Ms. FOX. We think it is simply an unfair business practice to change the price on debt that consumers have already incurred under an agreed-upon rate when they are not behind in paying that particular creditor.

Mr. TOOMEY. Do you agree that the failure to make a payment on another obligation is a reflection or certainly can be a reflection on the change in the creditworthiness of the borrower?

Ms. FOX. It could mean that another creditor made a mistake, it could mean they are counting you as late because payment came in at 2 o'clock and not 1 o'clock——

Mr. TOOMEY. And could it be that there is a change in the creditworthiness?

Ms. FOX. It could, but a creditor can adjust to that by, for example, on a credit card, lowering the credit limit rather than raising the price. There are other things that can be done without turning this into a profit center that consumers view as a gotcha.

Mr. TOOMEY. Do you think it also should be forbidden in the corporate environment? If it is unethical to do this with the consumers, is it unethical to do this with a small business owner?

Ms. FOX. Well, I try to represent consumer protection issues, and I don't speak to what happens with businesses. I would think that a business owner would be much more likely to be on a more level playing field with a lender, whereas the consumer credit contracts, these are contracts of adhesion. They are not negotiated between the consumer and the credit card bank; they are take-it-or-leave-

it agreements. They don't have the same leverage that you would have as a business owner.

Ms. DRAUT. One of the additional issues with the bait-and-switch practices is that credit card defaults, or default with another credit card, is not the only reason why a person's credit score would fluctuate or decrease, or go down in point. Oftentimes that may happen because they have actually taken on what I think most people would agree as productive debt: a new mortgage, maybe a new auto loan.

So it is not just about penalizing cardholders for being——

Mr. TOOMEY. Are you prepared to acknowledge that taking on additional debt is often an indication of diminished creditworthiness?

Again, going back to my little experience, one of the other provisions in these loan agreements was always that before you took on additional debt, you had to get an approval from the bank that was lending money in the first place because obviously too much debt diminishes your creditworthiness.

See, every way you look at it, it seems to me this is very often a reflection of risk.

Chairman BACHUS. Mr. Sanders?

Mr. SANDERS. I appreciate my friend's remarks. But in your opening thoughts, you used the word default, which I understand it means that you are late for 90 days and not paying your loan off. Do you see that as the same thing as somebody paying their loan at 5 o'clock in the afternoon rather than 2 o'clock being one day late—that is number one.

And the second issue: As you well know, credit card companies are substantially raising interest rates for no reason whatsoever. They tell you that they are going to charge you 7 percent and they double it for no reason at all. Do you think that that is appropriate?

Mr. TOOMEY. I think that if credit cards come out of the clear blue for no reason and double their rates, they are going to find they are losing a lot of customers and it is not a sustainable business practice.

So I think that the market is going to just prevent that from happening in a whimsical fashion.

Mr. SANDERS. I would disagree. Credit card companies are making huge profits. And as you know, in a busy world not everybody looks at their interest rates. Right? You know that. What they are looking at is they owe $50 at the end of the day.

I would hope that my friend would acknowledge that there is a lot of rip-off and unethical behavior going on here.

Chairman BACHUS. Let me interject. I actually taught this course in law school. It is an extremely complex issue.

Years ago we had divided courts of law and equity, and people would go into the equity court many times when debts were accelerated and the equity court enjoined that acceleration.

There are numerous exceptions being able to accelerate them. There would have to be reasonable causes.

What happens in a consumer standpoint is, they cannot go in and litigate each one of these where a business can.

It is not an altogether simple matter.

With credit cards today, you know, you have 20 pages of small print, and they do have the contractual right to do it.

There are laws on the books, however, but who is going to go into court over $100 and advance those laws.

Ms. FOX. Mr. Chairman, could I point to that as well?

These are retroactive rate increases. Consumers have obligated themselves for debt on their credit card at a certain price that they think they can afford. And if that interest rate is increased after the fact, and it applies to their total balance, now you have a purchase at a higher price that you did not budget for, that you don't have the capacity to pay.

And these are open-end credit transactions, not a closed-in loan that would accelerate if there were some change. We just think this is unfair to consumers, it undermines consumer confidence in the market, and it needs to be stopped.

Chairman BACHUS. It is an extremely complex issue. There is impairment of credit.

As Mr. Toomey said, I think in a lot of these cases, what allows them to do that is that there is something in the contract which says you have to receive permission. And that is true of almost— and that is why most of your business loans are accelerated because there are provisions in the original loan saying you are impairing credit.

And credit cards, I am not sure that that—in fact, in mortgages, in certain type, you know, State laws and federal laws actually prohibit acceleration.

I will say in defense of this committee, this committee almost overwhelmingly—Ms. Maloney offered an amendment, Mr. Sanders and I offered one, and there was a substitute by Ms. Maloney, and it overwhelmingly passed this committee in an attempt at least find a middle ground, and I think 90 percent of the members on this committee, if not 100 percent, it may have been unanimous, to address this issue.

It went to the House; it passed unanimously. And it went over to the Senate, and I am not blaming the other body, but when fair credit reporting came back to us, it was not on there.

This is a very emotional issue. I know there are members of this committee that have switched their opinion after they were—at least one high-ranking member of this committee that voted against Mr. Sanders' and my amendment, after he felt like he was bait-and-switched, he switched sides.

Obviously the problem with it is, there are obvious cases of tremendous abuse where people abuse it, get a lot of credit cards and they milk the system.

It is an issue that is with us, and hopefully in the future we will continue to look at it.

In defense of this whole committee, we came to a common ground in the House as to at least, you know, I think an appropriate thing.

Mr. Ross?

Mr. ROSS. On the issue of credit cards: You know, every week, just like every other member of Congress, I drive 2 hours to the airport—I guess some don't have it quite this bad—but I drive 2 hours to the airport, get there an hour early, and then fly to Mem-

phis and wait and hour and a half and then fly to D.C., and then a few days later do it all over again in reverse.

On the trip, the 2-hour trip from the airport to home each week, I go through my week's worth of personal mail. And I have been keeping a tally. On average—some weeks are more, some weeks are less; this tally has been going on for, well, approaching a year now—on average I will receive eight credit card applications per week.

My first question is: How many credit card companies are there? Can anyone answer that for me?

Mr. MCENENEY. I think there is something, like, in the U.S. 10,000-or-so different banks that issue credit cards.

Mr. ROSS. So eight times 50, so it is about 400, I am hearing from about 400 of them a year. So I have a ways to go.

You know, and I cannot help but think—I can remember when my wife and I were both in college and literally getting by on $400 a month. And thinking back to those days, you know, when you need new tires or your transmission breaks down or your washing machine breaks, for a lot of families that are barely getting by and for a lot of families that are living paycheck to paycheck, you know, maybe that first, second and third credit card application in the mail, they just throw away because they know they cannot afford to make the payments on it, they know they cannot afford the interest rates that come with it, they know that if they ever start using that card they will never get caught back up.

But by the time that sixth, seventh or eighth credit card application rolls around and they have a sick child or they have a car broke down, a lot of them are filling them out. And they are building up a debt, a debt that has now reached epidemic proportions, as is evidenced by the mass, a huge number, exorbitant number of bankruptcies that we see in this country today.

Now, granted a lot of those bankruptcies are coming from the 44 million people in this country who cannot afford health insurance. But a lot of them are coming from credit card debt.

And that troubles me. And I understand there has got to be some personal responsibility there and people have to think for themselves and make decisions for themselves.

But, folks, you know, when you get eight applications a week, sooner or later the enticement is going to be there. You know, when you are down on your luck and you need the money to go ahead and go for it, and then you spend the next few years trying to get out of debt, and when you cannot do it, then you file bankruptcy, which is certainly not good for anyone in this economy that we live in today.

What I am confused about—and I don't who at this table can answer this question.

I own a small business back home. I have 12 employees, so I know what it is like to meet a payroll every Friday.

I had an employee not too long ago that had run up one of these huge credit card debts and they were charging him 20-something percent. Just a low-to middle-class worker, working hard to support his kids. And he showed me one day, you know, and I look at it, and it was, like, in excess of 20 percent interest, and there was no way he was ever going to get caught up.

So I picked up the phone and I called the credit card company, did not tell them I was a member of Congress, I was just, you know, Joe Smith off the street. And I was able to negotiate a settlement for him to where if he paid it off—he paid something like, I want to say it was 35 cents on the dollar.

I mean, if credit card companies are able to take those kind of hits, there is got to be a lot of profit in this somewhere. And if I am just not following this thing—you all help me, whichever one of you think you are smartest on this issue, speak up, please.

Ms. DRAUT. I would like to answer that question.

I think you raised two questions.

I want to go back to your original question about how many credit card companies are there, because this has come up many, many times during this hearing, this issue of competition, free market, choice for consumers.

And I just want to point out to the committee that there are about 10 issuers of credit cards that control close to 80 percent of the market. Of those 10, we just had four merge into two. So we are going to have even less market competition in the credit card industry.

There really are not that many choices for consumers, because all of the major issuers follow each other's lead and engage in the same practices.

And now I am forgetting the last question you had that I volunteered to answer. I apologize.

Chairman BACHUS. Just ask the question over again, Mr. Ross.

Mr. ROSS. What I am trying to find out is, if you can settle for 35 cents on the dollar, then there must be a lot of profit somewhere in this business.

Ms. DRAUT. I wanted to mention that not every card company will agree to negotiate or to bring the card member's rate back down. It really depends on the luck of the draw. If you happen to get with a company that is open to helping you out, you are very lucky.

We have talked to a lot of people—and Mr. Meeks shared his personal experience, I want to share mine.

I have been penalized for a 1-minute late payment, called the creditor, said, "Why am I paying 27.99 percent?" No negotiation. "That is the rate, Ms. Draut, I am sorry."

So it is not across-the-board policy that card companies will in fact work with their customers to help them pay down the debt.

Mr. ROSS. Would you suggest that before people file bankruptcy that they reach out to these credit card companies and try to negotiate a settlement?

Ms. DRAUT. Absolutely.

Mr. ROSS. And again, I think that gets back to the basics we need: financial literacy.

You know, we have kids graduating from high school today that can do math I could not do in college and I cannot do it today. But they don't know how to balance a checkbook. They don't understand that when you borrow money you got to pay it back.

We need financial literacy in the classroom today, I believe.

Mr. MCENENEY. Congressman?

Mr. ROSS. Yes?

Mr. MCENENEY. Could I just add something to the answer?

You talked about the applications coming in. That is a reflection of the competition, the fierce competition, amongst these various players that really helps drive the cost of credit down, including credit card credit, and make it more widely available to all sorts of folks.

Now, on your question of, you know, can you take 35 cents on the dollar. The truth is, you cannot take 35 cents on the dollar too many times. But one of the only ways you take 35 cents on the dollar in the situation you talked about is if you are able to price for risk.

What that credit card issuer was able to do is determine that a certain number of people are going to default and to set the interest rate, the price, at the appropriate level so it could accommodate——

Mr. ROSS. Well, with a 21 percent interest rate, they must have been thinking a lot of people were going to default.

Mr. Chairman, I have one other very important——

Chairman BACHUS. And actually, Mr. Davis, if you—what we will do is, I will give you an additional—actually we have two other members that have not——

Mr. ROSS. We can come back.

Chairman BACHUS. Mr. Davis?

Mr. DAVIS. Thank you, Mr. Chairman.

The panelists should know the one way to get us inside the 5-minute rules is for votes to be called. So that is what happened. So it may make us all a little bit briefer.

Let me try to pose several quick questions. Let me start with Mr. Lively and McEneney.

One of the goals of this hearing has been to try to flesh out and identify possible areas of reform, possible things this institution can do that might create a fair and more equitable lending world.

Are there any institutional changes or any pieces of legislation, are there any reforms that are not on the books today that either of you would embrace, that you think would be salutary and would be helpful for the industry.

If you could each mention maybe one or two each.

Mr. MCENENEY. From my perspective, the key would be to focus the folks that are having difficulty repaying their debts, really come up with a solution that focuses on them.

You cannot restrict rates. If you restrict rates, you reduce credit availability to all sorts of people who pay their debts on time.

So I think the solutions have to focus on the people who are struggling. What is it that is going on with those folks that we could possibly help them with?

And I think the biggest issue, and probably the biggest thing we can do, is find ways to provide financial education so that they understand the economic consequences of the choices they make when they take on debt, and they can understand how much debt they can and cannot afford, and also to quite honestly drive them to develop habits to promote savings.

Focusing on financial education I think is the one most important thing we can do.

Mr. DAVIS. Is your answer essentially the same, Mr. Lively?

Mr. LIVELY. Just a little more meat on that answer, and that is, we have ourselves confronted with a conundrum here in terms of the basics of communication about all of this stuff.

On the one hand we have disclosures that are intended to inform and educate that are fairly extensive. In every agreement, you have just got a lot of disclosure.

One of the problems with that disclosure is the lack of understanding of financial issues causes the consumer not to pay attention to the disclosures. So when they get confronted with a change of terms that is arisen out of an agreement that is in the contract, they get very upset about it. And the fundamental is that circumstances that were previously agreed to have been imposed because of the change in the consumer's behavior and capacity, and that leads us into a cry for more disclosure or for some other remedial action.

The fact of the matter, if we can get people better educated in the scope of managing their personal financial affairs, they will avoid a lot of these things because they will have thought them through and they will understand better how to manage their affairs.

Mr. DAVIS. In the interest of time, let me ask a slightly different question to you all: Are there any institutional changes or proposed reforms that either of you think might potentially—speaking to Ms. Draut and Ms. Fox now—that either of you think might potentially go too far, that either of you think might have the perverse effect of constraining the availability of credit?

Ms. DRAUT. Well, that is a good question. And I don't think we have enough information, really, to answer that question accurately.

I don't think that we can just take opponents of some re-regulatory steps' word for it. I think that is the easy answer and the easy fear to put out there, that we will shut off access to the credit market. I think we need a lot more research and understanding. We need to model the effects of certain regulatory steps and see what the real effect may be.

Mr. DAVIS. One quick question, because our time is running down, and I want to certainly give Ms. Maloney adequate time to ask questions.

As far as the payday lending institutions go, I understand that in an ideal world you probably would favorite it if they did not exist at all, but it is not the world that we live in. They exist in a number of states.

If you had to design two characteristics that would make payday lending institutions more equitable and more responsible, what would those two characteristics be?

Ms. FOX. That they not be allowed to ask consumers to write checks without funds on deposit to secure the loan, and that the rate and repayment terms be affordable so that consumers can actually manage to pay off the loans without getting caught in a debt cycle in order to keep their checks from bouncing so they can pay off these loans.

It is the single balloon payment and the very high rate and the fact that they are holding your check that turns what should be a regulated small loan into a debt trap.

Chairman BACHUS. Thank you.

Ms. Maloney?

Mrs. MALONEY. Thank you very much. I would like to thank you and the ranking member for your leadership on consumer protection issues and other items before this committee.

As was mentioned earlier, we all worked together on the bait-and-switch. It was my compromise on the floor, that at least should be notified of any change in rate. It was removed from the bill in the conference committee.

But I would like to hear your feelings on notice for cash advances. A lot of times you will have a credit card at 6 percent or 7 percent, yet the cash advance jumps dramatically to 19, 20 percent. And I certainly think there should at least be notice, that people understand that.

I remember I put one bill before this body that there was a great deal of opposition to. And it merely required for notice for ATM machines, that if you are going to charge a fee, then at least let the consumer know that the fee is being charged and let them make that decision.

I gladly pay my ATM fee because of the convenience of being able to get to my checking account here in Washington or wherever.

But I think at very least, there should be notice and I would like your comments on that.

But I want to ask you a question about an item that was actually on the floor today and debated on the floor today, and it was on the floor this morning, and it was basically the efforts of the OCC to preempt State banking regulators.

A number of us on this committee are concerned that the result will be to deprive our constituents possibly of the consumer protections that they have at present in their localities and States. We are not sure that OCC has the resources or the knowledge to duplicate the efforts of the 50 states.

Legislation has been introduced by one of our colleagues, Congressman Gutierrez, to address this problem. It was on the floor today in the form of an amendment. But this subcommittee has not addressed it yet, and I hope they will.

But I would like to ask the witnesses about the OCC's letter yesterday—I don't know if you have had a chance to see it—in which they advised that certain credit practices are not acceptable for national banks. And is that effort enough? How does that effort compare to State regulation on bait-and-switch and other areas? Do you have a view on the OCC's preemptive efforts?

Mr. MCENENEY. I would be happy to respond to that.

First, I have heard that folks may be concerned that the OCC's preemption efforts may reduce consumer protection in some way. But I think when you step back and look at the extraordinary powers that the OCC has—and the letter is an example of that, which I will come to in a second—to regulate the banks that are within their jurisdiction, it really is extraordinary.

They have the authority to regulate, which is to tell the banks what they can and cannot do; they have the authority to examine them, which is to come in and figure out whether the banks are doing that or not; and to supervise them, which is to say, if they don't like the direction a bank is heading in, they can stand over

the bank's shoulder and say, "We would like you to go in this direction." And if they still don't like the way it is going, they can take the wheel and direct the bank more firmly.

What that enables the OCC to do is to issue things like this advisory letter—now, some folks say, "Well, it is just an advisory letter." I can tell you, advising national banks, there is no such thing as just an advisory letter.

What this letter means, if you are a national bank, is, you better pay attention.

And I can tell you, across the country over the next few days and weeks, national banks will be looking at that letter, going back to their practices, figuring out whether any of their practices raise issues under that letter, and if they do, change them. And if they don't change them—which I think would be the exception—examiners will come in and change it for them.

It is extraordinary power, and what it results in is this extremely efficient mechanism that the banking agencies have, like the comptroller, to impact behavior simply by having access to a word processor.

They send out this notice, it impacts behavior throughout the country, and that is far more efficient in terms of regulating and addressing abusive practice than any other mechanism I am aware of.

Mrs. MALONEY. Any other comments?

Ms. FOX. Mr. Chairman, may I respond also to this question?

We think that the committee needs to finish its action on curbing the sweeping preemption of state law that the OCC has attempted. We did have a chance to look at the advisory that was issued yesterday, and we think that draws attention to the issues that you have been discussing. Some of the requirements are going to be quite helpful.

But simply disclosing the markup of interest rates because of a change in the consumer's creditworthiness, this does not go far enough. This needs to be prohibited, not just disclosed.

Mrs. MALONEY. Thank you.

Would anybody else like to comment?

I cannot walk as fast as the chairman, so I have to run to go vote. He beats me to the floor every time.

Thank you for your testimony and your work.

Chairman BACHUS. Thank you.

I am going to close out the questioning. I will ask any other committee members that if they have questions, we want to give everybody plenty of time. This is an important issue, consumer issues.

And I will ask, Mr. McEneney, does the federal government—whether that be Congress or the Federal Reserve—have a role in the regulation of interchange fees, particularly in the movement of so many transactions from cash or checks from which the regulatory role is very clear to debit or credit transactions?

Mr. MCENENEY. Mr. Chairman, I would be happy to answer that.

I should probably quickly point out, though, that I don't represent the companies that are involved in the interchange process on that issue, but I would be happy to respond based on my general knowledge of the industry.

Chairman BACHUS. That would be helpful.

Mr. MCENENEY. You know, I think when you take a look at what interchange fees are, they are fees that are charged to banks that are parties to a payment card transaction, and the fees are set among those banks, commercial enterprises.

And so I think point number one is, it is not a consumer fee; it is a fee that is set amongst commercial enterprises. And I think typically Congress and the federal agencies would not get involved in that sort of fee arrangement.

The other thing I would point out is that given the competition that exists in this arena, with checks and cash and all sorts of payment cards, a wide variety of different payment methodologies competing, it would not seem that there would be a need to get involved in that issue on that basis as well.

And the final point I would make is that I think there are real distinctions between the federal regulators' involvement in cash and checks—which obviously are heavily dependent on the federal government, if not exclusively dependent on the federal government—to effectuate—either issue those payment methods, in the case of cash or to process the payments in the case of checks, I think those types of payment methodologies are totally distinguished from these private-sector organizations through negotiations with different commercial enterprises—set the prices.

And I really think for the federal government to get involved in that arena, it would be unprecedented, and I think probably have consequences potentially that would cause more harm than good.

Chairman BACHUS. Thank you.

Ms. FOX. Mr. Chairman, could I raise a related point?

These new forms of payment that depend on the electronic system that are developing outside the consumer protection laws have given consumers confidence in using credit, and to a lesser extent debit cards, for a long time.

And we do note that this week the Federal Reserve announced proposed changes to reg E, which implements the Electronic Funds Transfer Act, to apply those protections to the payroll cards. That does not go far enough. It needs to apply to all these new forms, a debit card that effectively takes the place of a consumer having a bank account note.

We don't have the liability limit, we don't have the dispute process, we don't have the disclosure requirements. We don't even know if FDIC insurance applies to the pool that store value cards draw from in all cases.

This is an area that we would urge this committee to examine as you go forward next year of harmonizing the consumer protections that apply to all forms of consumer payment mechanisms so that consumers don't have to know that there are three different ways their check can be processed, for example, depending on whether it goes through as paper, if it goes through the check-21 process, or if it is done through lockbox conversion at the place where you sent your mortgage payment.

Consumers have no control over that, but they don't know what the rules are because they are different every way that payments are processed. We really need to address that.

Chairman BACHUS. Thank you.

I will just close with a comment, if other members don't have questions.

This committee has tried to take a multiple approach to this whole issue of credit, availability of credit, creditworthiness and consumers and their rights and obligations under what is widespread availability of credit, which creates many opportunities but problems.

One of the things we have done is try to encourage them to migrate or utilize your credit unions, banks, more mainstream, get them into more mainstream financial institutions where the costs are less than, say, some of the, you know, check cashers, payday lenders, things of this nature.

Secondarily, we do think financial literacy is very important. You know, for many young Americans, financial literacy is getting overextended on a credit card. That is how they learn.

Unfortunately, what sometimes is available to the upper class and the upper middle class, income-wise, is a whole different world for those who don't have the resources to learn in a painless experience. For instance, if an upper middle class or upper class child from those families gets overextended on a credit card, it probably means a visit to mother or dad and they bail them out, and then they caution them not to let that happen again.

With low-income kids, with low-wage earners, that is simply not possible.

Plus, financial literacy only—I think when you say financial literacy, know who you are dealing with, know what the contract is.

I think with the credit cards, okay, what is the rate? The rate is going to be that way for a year, okay. And you would have to read 25 pages and really have a law degree to figure out that that payment could change without you ever missing a payment.

And what I have done, I have actually—in 10 years I have had interest rates change on me, to my surprise. What I am able to do is write—I won't mention names. But other people, what they have done is simply paid it off and gone on. Well, pay it off and get another credit—you know.

That is not available to some people. They don't have $3,500 in the bank, see that their rate has gone up, get annoyed, write a $3,500 check and pay it off, or $1,500. It just simply—that is not an option for them.

So sometimes our own experiences—members of Congress on a salary of $160,000 is really not the experience of the average American in coping with these changes.

So these are difficult issues. This is why we had this hearing today.

And we welcome your testimony today. I think one benefit of it will be to read over your testimony closer in the weeks to come and hopefully come to some consensus. Because we do have, among young people in particular—Mr. Draut, you mentioned certain at-risk populations. It is an unmanageable problem for them in many respects.

We have to be, as Mr. Hensarling and Mr. Toomey said, we have to—in our system there is just a certain amount of paternalistic things. Government cannot be mom and dad. It cannot be the rich uncle.

But we appreciate your testimony. We appreciate all your testimony.

At this time our committee stands adjourned.

[Whereupon, at 12:40 p.m., the subcommittee was adjourned.]

APPENDIX

September 15, 2004

OPENING STATEMENT OF CHAIRMAN SPENCER BACHUS SUBCOMMITTEE ON FINANCIAL INSTITUIONS AND CONSUMER CREDIT "FINANCIAL SERVICES ISSUES: A CONSUMER'S PERSPECTIVE" SEPTEMBER 15, 2004

Good morning. The Subcommittee will come to order. Today the Subcommittee is holding a hearing entitled "Financial Services Issues: A Consumer's Perspective." This hearing supplements the numerous hearings this Subcommittee has held over the past two years, hearings which in many instances focused on how we can improve the regulation of our financial services markets for the benefit of consumers. For example, consumer benefits were the focus of our extensive hearings on the Fair Credit Reporting Act last year, our hearings on subprime lending, and our hearings on fighting fraud and protecting customer data.

I think it is obvious that the financial services marketplace from the consumer's perspective is appealing. For example, this Subcommittee heard from dozens of witnesses last year about how consumers benefit from our strong national credit system. Consumers of all income levels and all backgrounds enjoy unprecedented access to credit for homes, cars, education, or other items of importance. But our financial services marketplace is more than just the extension of credit. Consumers can access financial services, such as checking and savings accounts, or asset brokerage services, from a large number of financial institutions competing for their business. Accessing these types of services has become the model of convenience—consumers can use a branch office, an ATM, the telephone, or the Internet to complete virtually any transaction they desire at any hour of the day or night. It is absolutely astounding to think of the conveniences offered to consumers compared to even just 20 or 30 years ago. I am even more excited about the countless improvements that will be made in the next 20 or 30 years.

In short, financial services issues from the consumer's perspective are largely positive. However, that is not to say that some of us would not like to learn about whether additional improvements can be made. That is why I am pleased that we could schedule today's hearing. It is my hope that we will learn not only how the financial services industry has brought new and improved products to consumers in new and improved ways, but also what issues could use additional attention.

Many of the topics on our agenda today come at the request of several of my distinguished colleagues. For example, Ranking Member Sanders and I have had an interest in how credit card issuers increase interest rates or other fees in connection with a consumer's repayment history. I would like to note that our interest in this issue dates back to our consideration of the Fair and Accurate Credit Transactions Act which was signed into law last year. Mr. Sanders and I offered an amendment to prohibit certain practices that we termed "bait and switch" practices. The good news is that our amendment garnered 22 votes in the full committee. The bad news is that 44 of our colleagues did not agree with us. There were many more votes on the House floor for a similar amendment—142 to be exact. However, 272 Members voted against the amendment. Although this issue has obviously had a full debate, and has been considered and rejected on a bi-partisan basis, I agreed with a request from Mr. Sanders and Mr. LaTourette that it should be part of our agenda today.

Several of this hearing's other topics were requested by other Members of this Subcommittee. I know that Mrs. Hooley and Mr. Gutierrez have an interest in the potential for criminals to abuse ATM networks by operating an ATM to "skim" customer's ATM account numbers and PINs for later crimes. Many of my colleagues on the Democratic side of the aisle, including Ranking Members Frank and Sanders, Ms. Maloney, Mr. Watt, and Mr. Ackerman, requested that the regulation of check overdraft protection services appear on our agenda. Mr. Sanders also requested a hearing on refund anticipation loans. Of course, I expect

at least some of our Members will also want to talk about other current issues, such as the efforts to improve consumers' financial literacy.

As should be evident, our plate is full today. That is why I am pleased that we have assembled a fine panel of witnesses to discuss this broad range of topics. Testifying before us today we have Mr. Michael F. McEneney, who is a partner in the Washington, DC office of the law firm Sidley Austin Brown & Wood LLP. Mr. McEneney is an expert on a variety of consumer credit and retail banking issues. He is testifying on behalf of the Consumer Bankers Association. We will also hear from Mr. Randy Lively, the President and CEO of the American Financial Services Association. Representing the Consumer Federation of America, we have Ms. Jean Ann Fox, the Director of Consumer Affairs for the CFA. Finally, we will hear from Tamara Draut, the Director of the Economic Opportunity Program for Demos: A Network for Ideas and Action.

I want to thank each of the witnesses for agreeing to testify before us today on a voluntary basis. It is my hope that you will not regret your decision. Although the witnesses represent a broad cross-section of interests, I do not expect that each witness will be an expert in every single topic we have before us today. Given the range of topics we may cover, I am not sure such a witness exists. I would also like to point out that I intend to bring this hearing to a close no later than 2 p.m. today in order to allow several of our Members to make the requisite arrangements for Rosh Hashanah.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement he would like to make.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

September 15, 2004

Hearing on "Financial Services Issues; a Consumer's Prospective"

Thank you, Chairman Bachus, for holding this important consumer protection hearing. I am proud of the way this Committee has come together in a bipartisan fashion to acknowledge the many different consumer protection concerns of members on both sides of the aisle.

This Committee has shown time and time again a commitment to expanding the financial services marketplace while protecting the American consumer. Last year, our Committee both increased the efficiency of the marketplace and bolstered consumer protections with the passage, and subsequent signing into law, of the Check Clearing for the 21st Century Act and the Fair and Accurate Credit Transaction Act. This hearing only further highlights our commitment to the American consumer.

The modern U.S. economy offers consumers unparalleled access to a variety of financial products and services. For example, any consumer can open a checking account from a variety of banks and virtually any consumer can obtain needed credit from a variety of lenders. In fact, consumers are now able to access many of these financial service products 24 hours a day, 7 days a week though the use of the Internet and other automated mechanisms.

We have today some of the lowest mortgage rates and credit rates on record, with more competitive offerings for consumers than ever before. Mortgages and credit approvals that used to take weeks or even months are now completed in a matter of minutes. Consumers not only have more choices and better rates, but also benefit from more rights and protections than they have ever had before.

The evolution of the financial services marketplace has resulted in enormous benefits for consumers, especially those who traditionally could not access financial services. There used to be a saying that you could only get a loan if you could demonstrate to the bank that you did not need one. That is no longer the case. Today, there is little question that virtually any consumer, even those with lower incomes or less than perfect credit histories, can access funds to finance a home, a car, or other expenses.

With the abundance of credit and a staggering number of financial products now available to consumers, it is imperative that consumers know their rights and

are able to protect themselves against unscrupulous operators. The more financially sophisticated a consumer is the less likely he or she will be to fall prey to abusive credit arrangements or other financial scams. I am proud to say that this Committee has a shown its commitment to promoting financial literacy through the creation of the Financial Literacy and Education Commission in the Treasury Department under Title 5 of the Fair and Accurate Credit Transactions Act.

While competition and innovative new products continue to benefit all consumers, it is imperative that we ensure that their protections are not compromised.

Thank you again, Chairman Bachus, for initiating this valuable hearing, and I look forward to the testimony of our witnesses.

Statement of Congressman Michael N. Castle

Financial Institutions Subcommittee Hearing on "Financial Services Issues: A Consumer's Perspective"

September 15, 2004

Thank you Chairman Bachus and Ranking Member Sanders for holding this hearing before the Financial Institutions and Consumer Credit Subcommittee today.

Now more than ever, we live in a world that has become increasingly complicated when it comes to personal financial matters. A generation ago, a basic knowledge of balancing a checkbook and maintaining a savings account was adequate. However, in today's complex world many Americans are faced with difficult decisions such as determining what type of loan they need; whether to invest in stocks or bonds; how to best manage credit; and how soon to start planning for family education needs and their retirement. There are approximately 40,000 different credit card products available, an intimidating thought for the most educated consumer.

Unfortunately, large numbers of consumers never learn the basics of maintaining their personal finances and may struggle unnecessarily with choices leading to financial freedom. Today, our nation's youth are bombarded with a multitude of financial options at an increasingly young age. Yet many are ill-equipped to make informed decisions about financial matters. According to a 2001 Teenage Research Unlimited survey, teenagers spend rather than save 98 percent of their money, a total of $172 billion in 2002.

Various public and private organizations have developed programs to promote public knowledge of basic finances. Many of these organizations are working with elementary and secondary students to provide them with a strong education in money management and provide teacher training on how to integrate basic financial education principles into curricula.

For example, in my home state of Delaware, MBNA opened the Financial Advisory Service (FAS) over ten years ago, which offers professional advice to MBNA people and their immediate family members. Since the service was established, MBNA has extended the service into the community and into the local school systems through the facilitation of basic credit and money management curriculum to all grade levels in elementary, high schools, and colleges throughout the country. FAS has educated nearly 1,500 students in Delaware 14,000 students throughout the country since 1995. I think all of the organizations offering financial literacy programs to our communities should be applauded.

Although some consumers view the large number of credit options to be daunting, the strong national credit system in the United States has been a driving force that has helped sustain our economy in recent years. That system is supported by the Fair Credit Reporting Act, which this committee reauthorized last year, and ensures that factual information is available on which to base the extension of credit, employment or insurance. Virtually every business in this nation, and every consumer that has ever used credit, depends on this system. Without this strong national system, consumers would pay higher costs for credit.

Educating consumers and enabling individuals to understand all of their financial options and opportunities is a daunting task, the review by this Subcommittee today will help us better understand how consumers and the financial services industry can have a more symbiotic relationship. Mr. Chairman, I thank you for holding this hearing today and I look forward to hearing from each of our witnesses.

September 15, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing entitled, "Financial Services Issues: A Consumer's Perspective"

Thank you, Mr. Chairman, for calling this important hearing to allow us to discuss the consumer's perspective on our financial marketplace and for your leadership on these issues.

In today's market, the American consumer has unprecedented access to a wide range of financial products and services including many specifically designed to meet that consumer's individual needs. Increasing competition has been the driving force behind innovation in the United States, reducing inefficiency in the marketplace and expanding services to a larger number of consumers. As we all recall from our debate on the Fair and Accurate Credit Transactions Act or FACT Act, the speed and sophistication of credit decision making has increased dramatically in recent years, allowing a larger number of consumers to gain access to a wider variety of credit products.

This Committee has the responsibility to ensure that as our market develops and advances, so do important consumer protections. In passing the FACT Act we met this obligation with the inclusion of several important consumer protection provisions to combat identity theft and bring greater transparency into the credit reporting process.

However, concerns remain regarding several consumer protection issues that merit further review. Many are byproducts of new services currently available in the marketplace and I look forward to hearing from our witnesses this morning on the reaction of the financial services industry to such problems once they are identified and their suggestions for future action.

Thank you again, Mr. Chairman, for calling this important hearing and I look forward to an informative session.

COMMITTEE ON TRANSPORTATION
AND INFRASTRUCTURE
CHAIRMAN, SUBCOMMITTEE ON
ECONOMIC DEVELOPMENT, PUBLIC BUILDINGS
AND EMERGENCY MANAGEMENT

COMMITTEE ON
GOVERNMENT REFORM

COMMITTEE ON
FINANCIAL SERVICES
VICE CHAIRMAN, SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT

COMMITTEE ON
STANDARDS OF OFFICIAL
CONDUCT

Steven C. LaTourette
Congress of the United States
14th District, Ohio

September 15, 2004

Thank you, Chairman Bachus, for holding this hearing and giving us a chance to examine many of the issues before this Committee specifically from a consumer's perspective.

During consideration of the FACT Act last year, this Committee tackled a set of what I believe are the most important consumer protection laws under our jurisdiction. Our national credit granting system is unparalleled in the world. But with credit becoming available to more and more Americans, increasing amounts of fraud, scams, and deceptive practices begin to work their way through the system.

It was a pleasure to work with Chairman Bachus and my friend from Oregon, Darlene Hooley, on identity theft legislation that eventually became part of the FACT Act. Our measure puts in place important new consumer safety standards that give every American who has established credit new tools to protect themselves from identity theft, and the means to more easily fix the situation should an identity crime be committed.

Also during this debate, Ranking Member Sanders and Chairman Bachus offered an amendment to prohibit the practice known as "bait and switch" which, in my opinion, produced some of the most intelligent, productive debate I've witnessed in this room. When we began debate on Mr. Sanders' amendment, I was not in favor of what he was trying to do. I think it's appropriate for an organization that issues credit not only to look at a general credit report and credit worthiness, but also to look at the broader portfolio and how much a person is in debt. It seems only sensible to me that a consumer could have a credit card that he or she paid on time each month, but default on a car payment, house payment, school loan payment, and default on all other credit cards, and no one could take that into consideration.

However, after listening to the debate and the points made by my colleagues on both sides of the issue, I was absolutely convinced to support the Bachus/Sanders/Maloney amendment, and later, to join Mr. Sanders in writing to Chairman Bachus requesting a hearing in our subcommittee on the "bait and switch" topic.

Credit issuers send out an estimated five billion offers of credit annually to Americans regretfully, of varied ages – evidenced by Mr. Bachus' teenage son receiving an offer for a $5,000 line of credit. Many of these mailings entice consumers with promises of incredibly low interest rates and other incentives. It's not surprising then that many American consumers sign up for these offers.

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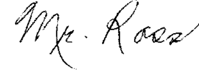
But if one of those consumers, for example, borrows an additional sum of money for something like a medical emergency, and makes all payments on time, that low introductory offer they agreed to and have fulfilled their obligation to can, without warning, become a credit burden with a 25% APR that can make it incredibly difficult to get out from under. It's been suggested that this factor drives many individuals and families into bankruptcy, and I'm inclined to believe there's some truth to that.

I understand risk-spreading, and I understand the need to look at the big picture. But despite all our great debate, and all the witnesses from industry we've heard from in this Committee, I am at a loss as to how that loan to cover a medical emergency changes the cost at all to the organization that extended you the offer of credit at a low rate.

I hope the dialogue we will hear today can provide some insight into that question. As a whole, I believe of credit granting system and the fine organizations and corporations that supply the capital necessary to make it run so smoothly do an outstanding job, and have helped many dreams come true for folks trying to get into a new home, or a new car. But I continue to believe that there are just some practices that are inherently unfair and out of balance between the needs of the consumer and the needs of the organization.

Thank you, Mr. Chairman.



Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
"Financial Services Issues: A Consumer's Perspective"

- Thank you Chairman Bachus and Ranking Member Sanders for having this important hearing to discuss various consumer perspectives about products and practices within the financial services industry.

- With the increase in competition and innovation that has occurred in the marketplace, the American consumer is able to obtain a variety of products suited to their need, such as the payday loan.

- I am concerned that existing federal law has not kept pace with the speed of the marketplace. I encourage the Committee to continue its review of these laws and update them where necessary.

- In the meantime, federal regulators have opted to make recommendations and provide guidance to financial institutions that participate in certain transactions.

- I believe this is appropriate and confirms the need of these products by consumers and should be encouraged to preserve the safety and soundness of these institutions to offer the products safely while providing adequate consumer protections.

- In today's economy, the demand for short-term, small denomination credit is strong.

- Payday loans are meeting a need of middle-income Americans for short-term credit. An estimated $25 billion in payday loan credit was provided last year.

- Those who are critical of these loans often focus on the Annual Percentage Rate (APR) that is applied. I believe this argument is misleading. A payday loan provides a viable alternative to consumers that are in need of short-term credit who may otherwise incur the expense of bounced check fees, credit card late payment charges, and other types of penalties.

- I urge the consumer groups to work with industry to ensure that those who utilize such products receive adequate protection while having access to these services.

- Again, thank you for convening this hearing and I look forward to the testimony of our witnesses and continuing to work with the interested parties on these important issues.

Testimony of Tamara Draut,
Director of the Economic Opportunity Program, Dēmos

Before The Subcommittee on Financial Institutions and Consumer Credit

Regarding Financial Services Issues: A Consumer's Perspective

September 15, 2004

Chairman Bachus and Ranking Member Sanders, thank you for the opportunity to testify today on issues facing households in credit card debt. I am here representing Dēmos, a nonprofit, nonpartisan research and public policy organization working on issues related to economic security. Over the last two years, Dēmos has produced several research studies on the growth of credit card debt and possible factors driving the rapid rise in credit card debt among the entire population as well as certain sub-groups. Our concern with the growth in unsecured debt was borne out of overarching interest in the state of family economic well-being in the midst of a changing economy. Our research points to an increased reliance on credit cards as a way families have coped with rising basic household costs in the face of slow or stagnant income growth. The rise in credit card debt, however, also raises additional concerns about the ability for families to build assets and savings, particularly as high interest rates and fees are siphoning additional money out of the family paycheck. In researching and documenting the rise in credit card debt, Dēmos became aware of the role that credit card industry practices play in the ability of indebted families to pay down their credit card debt and get back on the path to financial stability.

Many consumer organizations have long been concerned with the widespread use of abusive lending practices by credit card companies and other lending institutions. Dēmos applauds the work of the Consumer Federation of America, US PIRG, the National Consumer Law Center, and many others for their vigorous championing of reforms to protect consumers. Dēmos seeks to add to this perspective how the growth in credit card debt threatens family economic well-being and, by extension, the consumer-driven economy at large. During my testimony, I will specifically address the following issues related to credit card debt and industry practices:

1) Trends in credit card debt among households, highlighting groups of the population that are particularly strained by rising debt such as seniors, young adults, and middle-class households;
2) The rise in fees and interest rates charged by card companies after two Supreme Court cases which resulted in the deregulation of the credit card industry;
3) The capricious use of penalty rates and fees that result in a cardholder's interest rate doubling or tripling, including the practice of raising a cardholder's interest rate due to payment history with other credit accounts (commonly known as universal default or "bait-and-switch");
4) The application of interest rate changes retroactively, which results in consumers paying off their purchases at a rate different from the one in which they based their purchasing decisions under; and
5) The lack of information provided to consumers about the length of time and interest cost of only making minimum payments.

The Growth of Credit Card Debt

Between 1990 and 2001, revolving consumer debt in America more than doubled, from $238 billion to $692 billion. Credit card debt continued to rise in the new century--increasing by 7.2 percent from $703.9 in 2001 to $754.8 billion in 2004. The savings rate has steadily declined, and the number of people filing for bankruptcy since 1990 has more than doubled to just over 1.6 million in 2003.[1] As a result of rising credit card debt, each year more children now suffer through a parent's bankruptcy than through a divorce.[2] Despite record levels of mortgage refinancing, historic low interest rates, and unprecedented appreciation of home values, household debt service burdens have reached record highs. The financial obligations ratio, which provides a more accurate snapshot of household burdens of Americans, is at a record 18.5 percent. By the end of 2003, household debt had reached a record high 116 percent of income, according to data from the Federal Reserve.

These aggregate level trends illustrate that American households are accumulating increasingly higher amounts of credit card debt, with rising numbers suffering a total financial collapse. To better understand how these aggregate trends have played out at the household level, Dēmos has researched credit card debt trends among various demographic groups using data from the Federal Reserve Board's Survey of Consumer Finances (SCF). The most recent available data is for 2001, which does not capture the full effects of the recession. Our research examines in credit card debt *among cardholders with credit card debt* – about 55 percent of cardholders in the 2001 survey.

[1] American Bankruptcy Institute. "U.S. Bankruptcy Filings 1980-2003."
[2] Elizabeth Warren and Amelia Warren Tyagi. *The Two-Income Trap: Why Middle Class Mothers and Fathers are Going Broke.* (New York: Basic Books) 2004.

By excluding those families that do not have revolving (outstanding) balances on their credit cards, we can get a more accurate picture of the problem of credit card debt.

My testimony today highlights only a few key findings. For complete details on the growth of debt please see Dēmos reports, *Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 1990s* and *Retiring in the Red: The Growth of Debt Among Older Americans*. They are available on our website, www.demos-usa.org .

Our research has found that four groups have experienced the most rapid rise in credit card debt since 1992. These four groups are senior citizens, adults under age 34, and low- and middle-income households. As Table 1, illustrates, the average amount of credit card debt among all households with credit card debt grew 53 percent between 1989 and 2001. The average self-reported balance of indebted households was $4,126 in 2001. It is important to note that the SCF data are based on self-reported amounts of debt by respondents. There is evidence that consumers tend to underestimate their credit card debt. This is suggested by comparing self-reported debt to aggregate figures reported by the Federal Reserve. For example, based on the total credit card debt outstanding in 2002 ($750.9 billion), the average household debt was $12,000 in 2002—roughly three times higher than that reported by families in the SCF survey.[3]

[3] The absolute figures (for example, $4,041 of average debt) are based on data that consumers reported about themselves in surveys. Aggregate data on outstanding revolving credit reported by the Federal Reserve puts the average credit card debt per household at about $12,000—nearly three times more than the self-reported amount.

Table 1. Prevalence of Debt and Average Amount of Debt, by Income Group (2001 Dollars)

Family income group	Families holding credit cards in 2001	Families reporting debt in 2001	Average credit card debt in 2001	Percent increase 1989-2001
All Families	76%	55%	$4,126	53%
< $10,000	35%	67%	$1,837	184%
$10,000 - $24,999	59%	59%	$2,245	42%
$25,000 - $49,999	80%	62%	$3,565	46%
$50,000 - $99,999	90%	56%	$5,031	75%
$100,000 or more	98%	37%	$7,136	28%

Dēmos' Calculations using 1989. 1992, 1995, 1998, and 2001 Survey of Consumer Finances

Credit Card Debt Among Different Income Groups. American families across all income groups rapidly accumulated credit card debt in the 1990s. According to the Survey of Consumer Finances, three-quarters of American families hold credit cards, with 55% of cardholders carrying debt on their cards. The growth of credit card debt over the last decade was not evenly distributed among income groups. As Table 1 shows, the greatest growth in credit card debt occurred among very low-income and middle-income households. Among the lowest-income households (annual incomes less than $10,000) credit card debt grew 184 percent between 1989 and 2001, to an average of $1,837. The percentage of these families with debt also increased dramatically over the decade. In 1989, about 49 percent of very low-income cardholders had debt. By 2001, 59 percent reported credit card debt.

The second-highest increase was among middle-income households (incomes between $50,000 and $99,999), rising by 75 percent to $5,031 in 2001. The burden of credit card debt also shifted to a smaller percentage of middle-income families: the percentage of cardholders reporting credit card debt dropped from 64 percent in 1989 compared to 56 percent in 2001. In addition, the percentage of middle-income families with heavy debt burdens, that is total debt-to-income ratios greater than 40 percent,

(including mortgage debt) nearly tripled from 6 percent of families in 1989 to 16.3 percent in 2001.

Credit Card Debt by Race/Ethnicity. When we examine credit card debt trends by race/ethnicity, two important findings emerge. First, both Black and Hispanic households are less likely to have credit cards than are White Households. Second, both Black and Hispanic cardholders are more likely to be in debt than their White cardholding counterparts (Table 2).

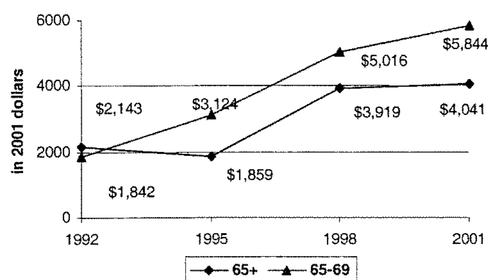
Table 2. Prevalence of Debt and Average Amount of Debt, by Race/Ethnicity. (2001 dollars)

Race/Ethnicity	Percent holding credit cards in 2001	Percent reporting debt in 2001	Average debt in 2001
All Families	76%	55%	$4,126
White Families	82%	51%	$4,381
Black Families	59%	84%	$2,950
Hispanic Families	53%	75%	$3,691

Dēmos' calculations using 1989, 1992, 1995, 1998, and 2001 Survey of Consumer Finances

Credit Card Debt Among Older Americans. Dēmos' report *Retiring in the Red* documented dramatic increases in the amount of credit card debt among older Americans. Roughly three out of every four Americans over 65 hold credit cards, a portion that increased slightly between 1992 and 2001. Of these cardholders, nearly one in three carried debt in 2001, a marginal decrease from 1992. While the percentage of indebted cardholders declined slightly, the amount of debt carried by older Americans grew precipitously. As Chart 1 shows, average revolving balances among indebted seniors over 65 increased by 89 percent from 1992 to 2001, to $4,041. Seniors between 65 and 69 years old, presumably the newly-retired, saw the most staggering rise in credit card debt—217 percent—to an average of $5,844.

Chart 1. Average (mean) Credit Card Debt
Older American Households, 1992-2001



Source: Dēmos' calculation of the 1992, 1995, 1998, and 2001 Survey of Consumer Finances

The true financial impact of debt can be seen in the percentage of income people must spend servicing it. A family spending more than 40 percent of their income on debt payments, including mortgage debt, is in a state of *debt hardship*.

Overall, seniors spend on average less than a tenth of their income on debt payments; however, those in credit card debt bear an increasingly heavy burden. Among seniors with incomes under $50,000 (70 percent of seniors), Table 3 shows that about one in five families with credit card debt is in debt hardship.

Table 3. Percent of Credit Card Indebted Older Families in Debt Hardship (Debt to Income Ratio > 40%)

Older Household Income Group	1992	2001
$0 - $14,999	14%	15%
$15,000 - $29,999	7%	18%
$30,000 - $49,999	9%	27%
$50,000 or more	9%	5%

Source: Dēmos' Calculations from the 1992 and 2001 Survey of Consumer Finances

Credit Card Debt Among Young Adults. Finally, younger Americans, those aged 18-24 years old and 25-34 years old, experienced faster growth in debt than the average household. In a forthcoming report to be released by Dēmos, we examine trends in credit card debt among young Americans as they try to establish their careers, start families and buy homes. The average credit card debt of Americans aged 25 to 34 years old increased by 55 percent between 1992 and 2001, to a self-reported household average of $4,088. This age group's bankruptcy rate grew by 19 percent over the same period—so that by 2001 nearly 12 out of every 1,000 young adults were filing for bankruptcy.[4] Young adults now have the second highest rate of bankruptcy, just after those aged 35 to 44. According to the Survey of Consumer Finances, nearly 7 out of 10 young Americans aged 25 to 34 have one or more credit cards, a level basically unchanged since 1992. Compared to the population as a whole, however, young adult cardholders are much more likely to be in debt: 71 percent of young adult cardholders revolve their balances, compared to 55 percent of all cardholders.

We found that 13 percent of young Americans experienced debt hardship in 2001—nearly double the percentage in 1992. Lowest-income young households are the most likely to be in debt hardship, but middle-income young adults are also experiencing higher levels of debt hardship. Young adults are having a harder time making payments, too. Nearly 1 out of 5 surveyed reported being late or missing payments within the last year on any loan, up from 1 out of every 6 in 1992.

The youngest Americans, those aged 18-24, more than doubled the amount of credit card debt they carried since 1992. Credit card debt among 18 to 24 year olds rose

[4] Teresa A. Sullivan, Deborah Thorne and Elizabeth Warren. "Young, Old, and In Between: Who Files for Bankruptcy?." *Norton Bankruptcy Law Advisor*, Issue No. 9A, September 2001.

by 104 percent, to an average of $2,985 in 2001. Although the Survey of Consumer Finances does not survey current students, it is very likely that the rise in the youngest adults' credit card debt is to some extent a result of rising credit card debt among college students. On-campus credit card marketing exploded during the 1990s, as creditors sought to saturate the youth market for the first time.[5] The co-branded college cards and student-conscious advertising and rewards programs were successful: in 2001, fully 83 percent of all undergraduates had at least one credit card, with the average student carrying four. Balances among college students have risen sharply over the last decade. Between 1990 and 1995, one survey found credit debt had shot up 134 percent, from $900 to $2,100.[6] In 2001, college seniors graduated with an average of $3,262 in credit card debt.[7]

Possible Factors Driving the Rise in Debt

While national survey research connecting the growth of debt to broader changes in the economy is unavailable, there is no question that many households are now turning to credit cards as a way to weather budget shortfalls. These shortfalls may be attributable to a range of factors, including job loss, medical illness, or divorce—the three leading precipitating factors to bankruptcy, according to the Consumer Bankruptcy Project. In addition, as low-to-middle-income households have experienced slow or stagnant wage growth, many are turning to credit cards as a way to deal with rising health care and

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[5] For a good discussion of campus marketing, see Robert R. Manning, *Credit Card Nation*, (Basic Books, New York) 2000.
[6] Robert R. Manning, *Credit Card Nation*, (Basic Books, New York) 2000, p.169 citing a study conducted by marketing research firm Claritas, Inc.
[7] Nellie Mae Corporation. "Undergraduate Students and Credit Cards: An Analysis of Usage Rates and Trends." April 2002.

housing costs. For a complete discussion of the economic trends that contribute to the use of credit, please see *Borrowing to Make Ends Meet* and *Retiring in the Red, both* available on the Dēmos website, www.demos-usa.org.

The availability of credit to weather economic shortfalls can be beneficial for households. Using revolving credit to pay off large expenses such as car repairs allows families to spread the payments out over several months, providing less disruption to the monthly family budget. Using credit to supplement a family's income during a job loss can help ensure the family stays afloat, allowing them to allocate precious financial resources to maintaining mortgage and rent payments.

Unfortunately, as households have become more reliant on credit cards to make ends meet as a result of greater instability in the economy and rising costs, the credit card industry has engaged in several practices that make it extremely difficult for indebted families to pay down their debt. The rest of my testimony will examine the changing practices of the industry and the deregulation that helped fuel the widespread exploitative practices used by lenders today.

Deregulation and Changes in Industry Practices

Beginning in the late 1970s, the banking and financial industry has been steadily deregulated. For consumers, this wave of deregulation has been a mixed blessing. It has expanded the availability of credit to many consumers formerly denied access to credit, but at a very high cost. This high cost, the result of finance charges, penalty fees, and increased credit lines, helped usher in the decade of debt.

Deregulation of the industry began with a Supreme Court ruling in 1978. In *Marquette National Bank of Minneapolis v. First Omaha Service Corp* (hereafter

Marquette) the Court ruled that Section 85 of the National Banking Act of 1864 allowed a national bank to charge its credit card customers the highest interest rate permitted in the bank's home state—as opposed to the rate in the state where the customer resides.[8] As a result, regional and national banks moved their operations to more lender-friendly states, such as South Dakota and Delaware, where there were no usury ceilings on credit card interest rates. In domino-like fashion, states began loosening their own usury laws. Today, 29 states have no limit on credit card interest rates.[9]

As a result of *Marquette*, credit card companies that are located in states without usury laws and without interest rate caps—all the major issuers—can charge any interest rate they wish, as long as they comply with consumer disclosure rules. The effect of this ruling had tremendous impact on the growth of the credit card industry and its profitability. Before *Marquette*, complying with 50 different state laws represented a high cost burden for the credit card companies. The *Marquette* decision allowed banks to nationalize credit card lending and take full advantage of the ease of centralized processing provided by the Visa and MasterCard systems. As a result, credit cards, which were once the province of the wealthy and elite business class, quickly became part of mainstream American culture. Riskier borrowers—often those on the lower end of the income distribution—were brought into the market, and lenders were able to charge higher interest rates to compensate for the increased risk.[10]

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[8] Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.
[9] Lucy Lazarony. "States with Credit Card Caps." Bankrate.com, March 20, 2002. <www.bankrate.com/brm/news/cc/20020320b.asp>
[10] David A. Moss and Johnson A. Gibbs, "The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?," 1999 National Conference of Bankruptcy Judges, p 13.

Credit card interest rates began to soar in the high-inflation post-*Marquette* environment, reaching averages of 18 percent, and have remained relatively high in comparison to drops in the federal funds rate (see Chart 2).[11] Several economists have remarked on the reasons why consumers continue to pay, and card companies continue to charge, exceptionally high interest rates. Some point to the high consumer transaction costs involved in switching,[12] while others point to a lack of competition in the credit card marketplace (market share by the top issuers has gone from 50 percent by the top 50 issuers the year before *Marquette*, to 78 percent by the top 10 issuers in 2002).[13] Whatever the reason, credit card companies did not lower their rates when inflation slowed and national interest rates came down. As a result, the card companies' "spread"—the amount charged above what it costs them to loan the funds—has remained consistently high, consistently at or above 10 percent over the last 15 years.

This trend has continued in the past decade, even as the federal funds rate and the prime rate dropped to historic lows. For example, in 2001 the Federal Reserve lowered rates eleven times, from 6.24 percent to 3.88 percent.[14] But these savings didn't get passed on to consumers: during the same period, credit card rates declined only slightly from 15.71 percent to 14.89 percent.[15]

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[11] See *Federal Deposit Insurance Corporation (FDIC)*: Bank Trends – The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate. *http://www.fdic.gov/bank/analytical/bank/bt_9805.html.* May 1998, p 8; David A. Moss and Johnson A. Gibbs, "The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?," 1999 National Conference of Bankruptcy Judges, p 13.

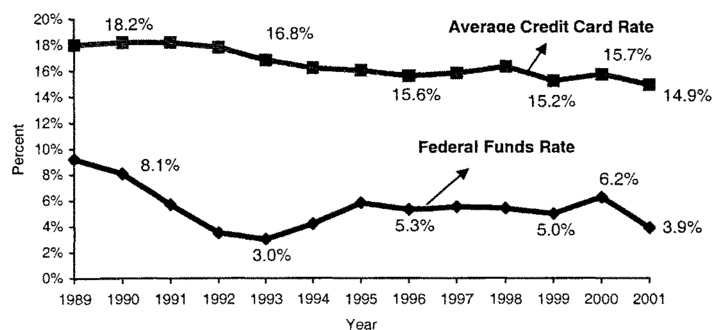
[12] See Vincent D. Rougeau, "Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates," *University of Colorado Law Review*, Winter 1996.

[13] Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000.

[14] Federal Reserve, Federal Funds Rate, Historical Data. Released April 28, 2003. http://www.federalreserve.gov/releases/h15/data/afedfund.txt

[15] US Census Bureau, *Statistical Abstract of the United States: 2002*, p 728.

Chart 2. Federal funds rate and average credit card rates



Sources: The federal funds rate data is based on historical data from the Federal Reserve. Average credit card rates are from the US Census Bureau, *Statistical Abstract of the United States: 2002*, p. 728.

The rise in credit card debt during the 80s and 90s reveals how quickly this transformation occurred: In 1999 dollars, from 1980 to the end of 1999, credit card debt grew from $111 billion to nearly $600 billion.[16]

In the mid-1990s, further deregulation of the credit card industry again contributed to the increasing costs of credit for consumers. In 1996, the Supreme Court ruled in *Smiley vs. Citibank* that fees could be defined as "interest" for the purposes of regulation. As such, under the rules established by *Marquette*, the laws regulating fees were now to be determined by the state laws in which the bank was located. Prior to the ruling, the card companies were bound by the state laws of the customers' residence.

[16] Robert D. Manning, *Credit Card Nation: The Consequences of America's Addiction to Credit,* (Basic Books: New York), 2000, pp 12-13. Figures adjusted to 1999 dollars.

Post-Smiley, credit card companies steadily raised the amount they charged in fees. For example, before Smiley late fees averaged $16. Now, it's $32.[17]

Industry Practices that Penalize Responsible Debtors

There are several practices that I would like to bring to the attention of the Committee during my testimony. The lack of national regulations regarding fees and interest rates, and the hobbling of state enforcement of their own laws, has resulted in consumers being unprotected from excessive fees and interest rates. The following practices are employed by all the major issuers and cost families billions of extra dollars every year.

1. Rate hikes and fees for late payments

All the major issuers now raise a cardholder's interest rate to a "default rate" when their payment arrives late—often to 29 percent or even 34 percent. Late payment penalties affect millions of cardholders of all credit risk levels, as there is no longer a late payment grace period. A payment is considered "late" if it arrives after 1:00 or 2:00 on the specified due date. Issuers have also begun systematically mailing statements closer to the due date, giving customers less turn-around time. The new default rates are applied retroactively—rather than to all new purchases. In addition to raising the interest rate on the card, issuers also charge the consumer a late fee, now typically between $29 and $39.[18] According to one survey nearly 60% of consumers had been charged a late fee in the past year.[19]

[17] Card Web. "Late Fee Bug," *CardTrak*, May 17, 2002; CardWeb. "Fee Revenues," *CardTrak*, July 9, 1999; Card Web. "Fee Escalation," June 18, 2003. www.cardweb.com.
[18] Ibid.
[19] Ibid.

Congress should amend the Consumer Protection Act or the Truth in Lending Act to define the parameters of "late payment" to ensure consumers are being treated fairly and appropriately. A late payment grace period of 3 to 5 days would be reasonable and ensure responsible cardholders are not unduly penalized. Penalty rates should be limited to an amount above the original annual percentage rate no higher than 50 percent of the original rate. (E.g., if the original APR is 9 percent, the penalty rate cannot be above 13.5 percent.)

2. "Bait and Switch" or Universal Default Policies

Card issuers now routinely check their cardholders' credit reports and will raise the interest rate on the card if there has been a change in the consumer's score. Known in the industry as "universal default",," these "bait and switch" policies are little more than preemptive penalties levied toward responsible debtors. For example, if a Bank One Visa cardholder is late on their MBNA MasterCard, Bank One will now raise the cardholder's interest rate—even if that cardholder has never missed a payment with them. Interest rate increases can also be triggered when a cardholder's profile has changed due to the addition of new loans, such as a mortgage, car loan or other type of credit.[20] These universal default practices should be prohibited.

3. New Low Minimum Payment Requirements

Credit card companies have also lowered their minimum payment requirement from a standard 5 percent to only 2 or 3 percent of the outstanding balance.[21] This makes it

[20] Amy C. Fleitas, "20 Sneaky Credit Card Tricks." Bankrate.com. www.bankrate.com/brm/news/cc/20021106a.asp.
[21] Ibid. See also Consumer Federation of America, Press Release, "Credit Card Issuers Aggressively Expand Marketing And Lines Of Credit On Eve Of New Bankruptcy Restrictions, February 27, 2001.

easier for consumers to carry more debt each month. It also ensures more interest income for the card companies, as consumers who pay only the minimum will revolve their balances over a longer period of time. Most consumers are unaware of how much interest and how long it will take to pay off their debt when only paying the minimum payment.

Consumers should be informed in their monthly statement about the cost of only paying the minimum amount, as well as the length of time it would take to pay off balances of various sizes by making only the minimum payment. Additionally, the minimum payment requirement should be raised to 4 percent of the outstanding balance for all new cardholders.

Table 4. Amount of time and interest payments for selected credit card balances and interest rates

Credit Card Balance	Annual Interest Rate	Years to Payoff Credit Card Debt	Interest Cost
$5,000	15%	32	$7,789
$5,000	18%	46	$13,931
$8,000	15%	37	$12,790
$8,000	18%	50	$22,805
$10,000	15%	39	$16,122
$10,000	18%	50	$28,524

Most credit cards assume a minimum payment of 2 percent of the balance or $10, whichever is higher. Source: Dēmos' calculations

4. Retroactive Application of Higher Interest Rates

The practice of raising a cardholder's rate to a "default rate" for payments that arrive hours after a mail pick-up, or for activity with another creditor is made worse by the fact that the new higher rate is applied to the cardholder's existing balances. By applying the rate change to previous purchases, card companies are essentially changing the terms retroactively on consumers, and in essence, raising the price of every item or service purchased previously with the card. Take, for example, a cardholder who buys a new

computer under the pretense that she will be paying back the price of the computer at the APR on her card at the time of purchase, which may be 9.99 percent. After one day-late payment on her account, the interest rate on her card is raised to 27.99 percent. As a result, this cardholder is now paying off the loan for her computer under drastically different terms than which she purchased the item. These severe default rates, levied even on customers who are paying their bills in good faith, if perhaps not in perfect time, constitute an enormous and undue increase in the cost and length of debt repayment for revolvers.

I have included in my testimony a copy of a credit card solicitation from Bank One. Like all standard agreements, the solicitation contains the following language:

> "We reserve the right to change the terms (including APRs) **at anytime for any reason**, in addition to APR increases which may occur for failure to comply with the terms of your account." [my emphasis]

In terms of a contract, consumers are already at an extreme disadvantage because the card the terms can be changed at any time.

Card companies should be held to the terms of the original contract for all purchases up to the initiated change. Any change made to the terms of the cardholder agreement in terms of increases in the annual percentage rate (or decreases if that may be the case) should be limited to future activity on the card.

Conclusion

In the face of rising costs for essential goods and services, many families have turned to credit cards as a socially acceptable solution for maintaining living standards during periods of income loss or stagnation. The credit card companies have responded to the increased financial vulnerability of many American households by further strapping customers with a high-cost combination of "gotcha" penalty interest rates and fees. ,In absence of stronger federal regulations or industry-driven reforms, the levels of debt accumulated by American households in the past decade may very well prove unsustainable on a number of fronts. Industry practices that make it harder for indebted households to pay down balances in reasonable amounts of time threaten the health of U.S. households, the health of our consumer-driven economy, and eventually, the health of the consumer lending industry itself.

Attachment:

Credit Card Offer from Bank One for a Visa Card.

Credit Card Offer from Bank One (Visa)

RATE, FEE AND OTHER COST INFORMATION

LGC3040

Annual Percentage Rate (APR) for purchases (including balance transfers, excluding overdraft advances)	A 0% fixed APR until the first day of the billing cycle that includes 7/01/05. After that, 7.99% variable.[4]
Other APRs	Cash Advance APR: 19.99% variable Default rate: 24.99% variable. See explanation below.[2] Closed account rate: 24.99% variable. See explanation below.[3] Overdraft Advance APR: 13.99% fixed (not available in some states)
Variable rate information	The following APRs may vary monthly based on the Prime Rate:[4] Purchase APR equals the Prime Rate plus 3.99% after the introductory period, but not less than 7.49%. Cash advance APR equals the Prime Rate plus 15.99%, but not less than 19.99%. Default rate and closed account rate equal the Prime Rate plus up to 20.99%.[5]
Grace period for repayment of purchase balances	At least 20 days, but none for balance transfers, convenience checks, or overdraft advances, if applicable.
Method of computing the balance for purchases	Two-cycle average daily balance method (including new purchases).
Annual fee	None
Minimum finance charge	$1.00
Transaction fee for convenience checks	3% of the amount of each transaction, but not less than $5.00 nor more than $50.00.
Transaction fees for cash advances	ATM cash advances: 3% of the amount of the advance, but not less than $10.00. All other cash advances: 3% of the amount of the advance, but not less than $15.00.

Late Payment fee: $15.00 on balances up to but not including $250, $35.00 on balances of $250 and over. However, if you already have made one or more late payments in the prior 12 month period, $35.00 regardless of the amount of your balance. **Over-the-Credit-Limit fee: $35.00**

Language addressing change in terms →

[1] You understand that the terms of your account, including the APRs, are subject to change. **This means that the APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs. We reserve the right to change the terms (including the APRs) at any time for any reason, in addition to APR increases that may occur for failure to comply with the terms of your account.** Any changes will be in accordance with your Cardmember Agreement.

[2] Your APRs may increase if you default under any Cardmember Agreement you have with us for any of the following reasons: we do not receive at least the minimum payment due by the date and time due as shown on your billing statement for any billing cycle in which a payment is owed, you exceed your credit line on this Account, you fail to make payment to another creditor when due, you make a payment to us that is not honored by your bank.

[3] If, at any time after your Account is closed, we demand immediate payment of your outstanding balance and we do not receive payment within the time we specify, we may increase your APRs on all balances up to the closed account rate stated above.

[4] The "Prime Rate" is the highest prime rate published in the Money Rates column of *The Wall Street Journal* two business days before the Closing Date on the statement for each billing period. Variable APRs above are based on the 4.00% prime rate on 4/22/04.

[5] We may consider the following factors to determine the default and closed account rate: the length of time your Account has been open, the existence, seriousness and timing of any defaults, and other indications of your Account usage and performance.

Transactions in Foreign Currency: Visa and MasterCard convert transactions in foreign currencies to U.S. dollars at a wholesale or government mandated rate. They add 1% to the amount. We add an additional 2% to the amount Visa or MasterCard provides to us.

Consumer Federation of America

Testimony of
Jean Ann Fox, Director of Consumer Protection
Consumer Federation of America

"Financial Services Issues: A Consumer's Perspective"

On Behalf of the Consumer Federation of America, National Consumer Law Center,
Center for Responsible Lending,
Consumers Union and the U.S. Public Interest Research Group

Before the House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

September 15, 2004

[6] FDIC Statistics on Depository Institutions, year to date June 30, 2004 Service Charges on Deposit Accounts $16,245,742,000 times two for annual total of $32.5 billion. Consultants estimate that NSF and OD fees make up conservatively 60 percent of total service charges and that individuals write about 60 percent of returned items.

Chairman Bachus, Ranking Member Sanders, and Members of the Committee, my name is Jean Ann Fox and I am the director of consumer protection for the Consumer Federation of America.[1] We appreciate the opportunity to offer our comments on financial services from a consumer perspective. My testimony will concentrate on emerging credit and debit products and their impact on consumers. This testimony is also being delivered on behalf of other national consumer organizations, Consumers Union,[2] the Center for Responsible Lending,[3] the National Consumer Law Center[4], and the U.S. Public Interest Research Group[5].

Quick Cash Credit Products Cost Vulnerable Consumers Billions of Dollars

In less than a decade, the quick cash credit market has become big business, costing financially vulnerable consumers billions in triple digit interest rates and fees. Excluding credit cards and cash advances on credit cards, new and risky methods of borrowing a few hundred dollars for a few weeks have become as widespread as they are controversial. These new products include payday loans, bounce loans which banks call "courtesy overdraft" programs, and tax refund loans. These three products target cash strapped consumers who have trouble

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[1] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[2] **Consumers Union** is the nonprofit publisher of Consumer Reports magazine. Consumers Union was created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

[3] **The Center for Responsible Lending** is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL (www.responsiblelending.org) is affiliated with the Center for Community Self-Help, one of the nation's largest community development financial institutions.

[4] The **National Consumer Law Center** is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of predatory practices against low-income people in almost every state in the union. It is from this vantage point - many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities - that we supply these comments. We have led the effort to ensure that electronic transactions subject to both federal and state laws provide an appropriate level of consumer protections. We publish and annually supplement fifteen practice treatises which describe the law currently applicable to all types of consumer transactions.

[5] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

making ends meet between paydays. Borrowers pay triple digit interest rates for money that must be repaid in full on the borrower's next payday, or when the tax refund is deposited in two weeks or less by the IRS. Consumers can also spend a lot of money very fast on the array of new plastic payment cards that are being offered, such as payroll cards and pre-paid debit cards. Unfortunately, federal requirements regarding disclosures, error resolution procedures, and liability limits for credit and debit products have not been updated to explicitly cover these types of products.

We urge Congress to take action to protect consumers, specifically:

- Stop the FDIC from allowing banks to enable payday lenders in evading state usury laws;
- Stop regulatory agencies from interfering with states' authority to regulate financial markets and protect consumers;
- Harmonize payment card protections upwards to cover emerging forms of electronic payment methods, such as requiring that FDIC insurance cover funds in payroll card accounts, setting liability limits and establishing error resolution procedures to protect consumers when cards are lost or stolen or mistakes occur in card use.
- Make all lenders comply with Truth in Lending Act disclosures and protections.

Consumers Enticed to Pay Billions to Write Checks Without Money in the Bank

Consumers pay a stiff penalty for inadvertently or deliberately overdrawing their bank accounts. A growing number of financial institutions now encourage their account holders to spend money they don't have by overdrawing their accounts, in order to collect more penalty fees. Checking account service fees are up thirty-four percent in the last three years, which is the same time span for the rapid adoption of bounce loan programs at financial institutions. Financial institutions last year collected approximately $11.7 billion in insufficient fund (NSF) and overdraft fees from individual consumers who overdrew personal bank accounts. Many banks use reverse order check clearing to increase the number of checks that bounce, package "free checking" with low balance requirements and "courtesy overdraft," and advertise that accountholders can overdraw their accounts when they run short at the end of the month. In addition, consumers paid payday lenders $6 billion in finance charges for loans based on checks for insufficient funds. This approximate $17.7 billion overdraft price tag does not include the penalty fees consumers pay merchants when their checks fail to clear the bank or interest and fees paid for refund anticipation loans, rent to own, and other high-priced financial services targeted to cash and credit-constrained consumers.[6]

Emerging High-Cost Credit Products Cloak their Identity to Avoid Protections

A troubling characteristic of many of these credit products is that lenders camouflage them as something other than a loan. Creditors do this so that they can avoid quoting the products' true price and evade consumer protections required with these loans. For example,

[6] FDIC Statistics on Depository Institutions, year to date June 30, 2004 Service Charges on Deposit Accounts $16,245,742,000 times two for annual total of $32.5 billion. Consultants estimate that NSF and OD fees make up conservatively 60 percent of total service charges and that individuals write about 60 percent of returned items.

payday lenders describe their loans as "deferred presentment." Banks call their overdraft line of credit loans "courtesy overdraft," or "bounce protection." Tax preparers tout "rapid refunds." Rent-to-own stores claim their customers are leasing appliances and furniture, not buying them on installment sales contracts. Purveyors of extremely expensive credit products are trying to avoid having to comply with Truth in Lending and other credit laws meant to protect and inform consumers and intended to provide a competitive marketplace for credit.

Fringe Financial Products Impact Vulnerable Consumers

Customers of quick cash lenders are disproportionately low and moderate income, minorities and credit-impaired families with little clout in the marketplace. Commercial tax preparers that sell high-cost refund loans cluster in working class communities. A study by the Woodstock Institute found that payday loan outlets are twice as likely to be located in predominantly African-American communities as in predominantly White communities. A drive around any military base will find clusters of payday loan outlets, rent to own stores, buy-here-pay-here used car lots, and other high-cost lenders. Banks now target low-margin consumers by marketing "Free Checking" in combination with "courtesy overdraft" loans, knowing that enough of them will overdraw their accounts to rack up high-fee income. Consumers already struggling to make ends meet are those most likely to pay the price.

Fringe Lenders Use Banks to Undercut State Usury Laws

Payday lenders who want to do business in states that have criminal or civil usury laws on the books, such as New York and North Carolina, partner with banks located in lax regulatory states, such as Delaware and South Dakota, and claim the right to make loans the non-bank lenders cannot legally make on their own. Only the FDIC now permits its banks to aid in this evasion of state consumer protections.

Some commercial tax preparers that peddle high cost tax refund anticipation loans also partner with a handful of banks located in states that do not cap interest rates. Low-wage workers are paying triple-digit interest rates for these loans (of less than two weeks in duration) just to get money faster than the IRS will deliver. Tax preparers could not make these loans at rates that far exceed many state interest laws without a bank involved.

Consumer Protections Are Not Keeping up with the Proliferation of Plastic Payment Cards

Another development that we urge this Subcommittee to examine is the proliferation of new forms of plastic payment devices and payroll delivery methods, including payroll cards and pre-paid debit cards. These new forms of payment fall through the legal protections provided for credit and debit cards and run the risk of isolating unbanked consumers in substandard financial products. It is unclear to what extent federal deposit insurance applies to pooled accounts used for payroll cards or under what circumstances the Electronic Funds Transfer Act covers prepaid debit cards. This means that consumers do not have the right to dispute erroneous transactions and have the amount in dispute restored to their account while the financial institution investigates, and do not have the right to get clear disclosures or account statements.

These new card products do not bring the unbanked into the mainstream but do come with hefty fees for users. The Federal Reserve Bank of New York reports a wide range of multiple fees that come with stored value cards. These costs of using plastic instead of a bank account can run as high as $39.95 to activate a card, up to $99.95 in annual fees, monthly fees as high as $9.95 per month, $2 for every time the card is used to buy something, and up to $2.50 to use an in-network ATM. Additional fees cover everything from overdrafts to speaking to a live person.[7]

I. Unsafe and Unsound Credit Products for Cash-Strapped Consumers

A. Payday Loans: Quick Cash for Cold Checks

Payday loans are small loans made to cash-strapped consumers, secured by a post-dated check or access to the borrower's bank account. Loans for up to $500 plus a finance charge of $15 to $30 per $100 borrowed are due in full on the borrower's next payday. Payday loans are made without regard for the borrower's ability to repay. The cost of payday loans averages 470 percent APR, far in excess of some state usury or small loan laws.

The Payday Loan Industry

The payday loan industry is made up of stand alone payday loan shops, such as Advance America, Check'n Go, and Check Into Cash; check cashing outlets that also make payday loans, such as ACE America's Cash Express and the Dollar Financial Group chain of check cashers; pawn shops, such as QC Financial and EZPawn; and companies that market payday loans via toll free phone lines and over the Internet.

Some lenders use thinly-veiled retail transactions to make payday loans that exceed state limits. Internet rebate plans and rebates with phone card sales are sometimes employed to evade consumer protections. The Indiana Department of Financial Institutions ruled that Internet rebate plans were illegal payday loans. Georgia's regulators issued a cease and desist order against a payday lender using phone cards to cloak illegal lending. Regulators in North Carolina, Kansas, and Arkansas have brought cases against sham lenders claiming to offer rebates with Internet access plans.

Industry analysts report that payday loan outlets now make $40 billion in loans a year at a cost to borrowers of $6 billion in loan fees. Growth in industry size is fed by additional states authorizing payday lending, expansion of lending into states through rent-a-bank arrangements and other devices, as well as repeat borrowing by current customers on a debt treadmill.

State Regulation of Payday Lending

Fifteen states prohibit payday lending through operation of usury or small loan laws and a growing number of states prohibit retailers from brokering loans for out-of-state banks. Alaska

[7] Federal Reserve Bank of New York, "Stored Value Cards: An Alternative for the Unbanked?" July 2004, available at www.newyorkfed.org/regional/stored_value_cards.html

enacted payday loan authorizing legislation that will take effect in 2005. Currently 33 states and the District of Columbia grant safe harbor for check-based loans with laws or regulations that carve out payday lending from usury and small loan laws. Two more states set no usury limits for small loans by licensed lenders.

Payday Loans Trap Vulnerable Consumers in a Cycle of Repeat Loans

Payday lenders encourage cash-strapped bank account holders to write checks without funds on deposit and then use those checks to coerce repeat transactions or collections. The combination of relatively large loan size, expensive finance charges, short loan terms, and check holding results in loan flipping that traps many vulnerable consumers in perpetual debt. A report issued by the Center for Responsible Lending estimated that 91 percent of all payday loans are made to borrowers with five or more payday loans per year and nearly one in three customers receive twelve or more loans per year.[8] Iowa regulators report that the average customer in 2003 had 12.31 loans at the same lender and almost 50 percent of customers had 12 or more loans in 2003 at the same lender.[9] Information supplied by Advance America in its IPO filing at the SEC revealed that its customers average over ten loans per year.

Rent-a-Bank Payday Lending

A handful of banks have chosen to "rent" their bank powers to pawn shops and small loan companies to assist those non-bank companies to make small loans at costs that would violate state laws. Under a "rent-a-charter" arrangement, the payday lender markets the loans, solicits borrowers, accepts applications, disburses loan proceeds, and services and collects the loans. The bank generally takes only a small percentage of the loan revenues – often as little as 5 percent -- while it's so-called "agent" takes the vast majority of the revenues generated by the loan.

Ten state-chartered FDIC-supervised banks partner with pawn chains, check cashers, and payday lenders, according to CFA's latest report, Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury. Payday loan banks include: County Bank of Rehoboth Beach, DE; First Bank of Delaware; BankWest, Inc., SD; First Fidelity Bank, SD: Community State Bank, SD; American Bank & Trust, SD: Bryant State Bank, SD: Reliabank Dakota, SD: Republic Bank & Trust, KY; and Venture Bank, WA.

Eleven of the thirteen largest payday loan chains use bank partners in states with consumer protection laws that do not permit unregulated payday lending, such as Pennsylvania, Arkansas, New York, North Carolina, Michigan, and Texas. Georgia recently enacted a law strengthening its enforcement tools to prevent usury and to prohibit rent-a-bank payday lending where the local storefront gets the majority of the money.

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[8] Center for Responsible Lending, "Quantifying the Economic Cost of Predatory Payday Lending," Dec. 18, 2003, p.2.

[9] Iowa DD Exam-Survey History, received Feb. 8, 2004, on file with author.

No federally-chartered financial institutions or state member banks partner with payday lenders, following regulatory action by the Comptroller of the Currency, Office of Thrift Supervision, and Federal Reserve. These regulators found that payday lending exposes federally-insured banks to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risk.

States Assert Authority over Small Lenders

States from California to Maryland have enacted anti-broker clauses in an attempt to prevent local lenders from partnering with banks to evade state consumer protections. In court litigation to date, none of these state anti-broker laws have been overturned. States with anti-broker provisions include California (effective in late 2004), Colorado, Indiana, Louisiana, Oklahoma, Virginia, Georgia, Maryland, Montana, and Massachusetts. Florida regulators report that they consider rent-a-bank arrangements a violation of their regulatory program. Federal courts in New York, Florida, Maryland, Colorado, North Carolina and Georgia have denied bank/payday lender claims to total preemption of state law and have remanded payday loan cases to state court, most recently in New York.

State regulators that have been and are currently actively fighting the rent-a-bank evasion of state small loan and usury laws include the New York Attorney General who is suing County Bank of Rehoboth Beach, DE and two of its loan-by-phone servicing companies; the North Carolina Attorney General and Banking Commissioner, who opened an investigation into Advance America's lending practices; and the Georgia Attorney General's office, which is in federal court to defend Georgia's new anti-rent-a-bank state law. Other states involved in regulatory action to prevent rent-a-bank payday lending include Ohio, Colorado, Oklahoma and Virginia.

FDIC Guidelines Protect Lenders, Not Borrowers

FDIC payday loan guidelines are no substitute for state usury and small loan laws and do not regulate loans made in partnerships between banks and third-parties. The FDIC guidelines do not cap fees for payday loans, set loan size or term limits, or prevent perpetual debt. FDIC subprime capitalization requirements have little impact on banks that immediately sell 85 percent or more of loans back to their payday loan partners. Most importantly, the FDIC failed to mandate that its insured banks assess ability to repay these loans, a decidedly unsafe and unsound practice. Moreover, the FDIC has not vigorously enforced its guidelines, encouraging additional state banks to enter the rent-a-bank business.

We applaud the Federal Reserve for choosing not to follow the FDIC's approach to permissive regulatory treatment of banks in the payday loan business.

Recommendations

We urge Congress to clarify that bank charters are not for rent and to insist that the FDIC take action against state banks involved in payday lending by prohibiting federally insured banks from directly or indirectly making payday loans. We believe that Congress never intended for

state chartered, federally insured banks to be empowered to rent their interest rate exportation powers to third party entities to make predatory loans. Rent-a-bank payday lending undercuts state authority to enforce usury laws, small loan regulations, and even state payday loan laws. We urge you to take immediate action to stop this practice.

We also urge Congress to stop lending that entices consumers to write checks without money in the bank, by prohibiting the use of checks drawn on federally-insured depository institutions as the basis for loans. Bills have been filed in prior sessions of Congress to accomplish this reform.

B. Truth in Lending Should Apply to Bank "Overdraft" Bounced Check Loans

The Federal Reserve Board recently announced new, proposed rules to cover overdraft extensions of credit under the Truth in Savings Act, Reg DD, instead of under the Truth in Lending Act. [10] That is a completely inadequate response to the real need consumers have for information about the exorbitant costs of these loan products. Congress should step in and require – at the least – that bounce loans be treated just as all other extensions of credit are treated under the federal Truth in Lending Act. This equivalent treatment would simply – and most importantly – require that creditors of bounce loans *inform* consumers about the true costs of this credit.

Bounce "protection" loans[11] are a new form of overdraft protection that some banks are using to boost their non-interest revenue.[12] It is a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit not only with checks, but using ATMs, debit cards and other methods. These plans offer short-term credit at triple-digit rates. Bounce loans are an extraordinarily expensive credit product. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243 percent. If the consumer pays the overdraft back in 14 days, which is probably more typical for a wage earner, the APR is 520 percent. Bounce loan fees can be triggered for overdrafts of a few dollars (especially for debit card point-of-sale overdrafts), making the APR even more astronomical. And once a consumer triggers an overdraft, it can start a chain reaction of fees as further overdrafts occur by means of checks, ATM transactions, debit card transactions, automatic payments, and other methods.

Bounce loans made by ATM and debit cards are especially unfair because consumers don't expect to overdraw using these devices. The banks' claim that bounce loans save consumers merchant returned check and other fees does not apply, since no check has been

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[10] Comments of the National Consumer Law Center, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, and Woodstock Institute to the Federal Reserve System, 12 CFR Part 230, Docket No. R-1197, "Proposed Amendments to Regulation DD and Proposed Overdraft Protection Guidance," August 6, 2004, available at www.consumerfed.org/

[11] Bounce "protection" is a euphemism used by banks to describe this high-cost credit product and is used to distinguish this non-contractual product from tradition overdraft protection.

[12] For more information on bounce credit, see Consumer Federation of America & National Consumer Law Center, *Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks* (2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.

written and a withdrawal or purchase can simply be denied for lack of funds. There is no purpose in allowing overdrafts by ATM and debit card except to provide payday loans and high-priced credit cards.

When a consumer uses bounce credit, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit, even where that deposit is protected income, such as a welfare or Social Security check. The fee is often the same amount charged for an NSF fee on a returned check, typically $20 to $35 per overdraft, and in some cases the bank also charges an additional, $2 to $5 per-day fee. All of the federal banking regulators have recognized that this product is credit as defined by TILA.[13] Some state regulators have reached the same conclusion.[14]

According to the American Banker, nearly 3,000 banks now offer bounce protection.[15] A survey by the Woodstock Institute, included in comments filed with the Federal Reserve in August, found that seven of the largest banks in Chicago, which control over 50 percent of the market share in that city, have instituted bounce loan programs.

Consumers Find Key Features of Bounce Loans Unfair

Recently, a survey poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International (ORCI) asked consumers their opinion about two features of bounce loans. The survey asked consumers about their opinions on the fairness of: 1) permitting overdrafts without obtaining the consumer's affirmative consent; and 2) permitting customers to overdraw their accounts at automatic teller machines (ATMs) without providing the consumer with any notice or warning of the overdraft on the ATM screen or asking for consent to advance funds and impose a fee.

Well over twice as many consumers thought that banks permitting overdrafts without obtaining the consent of their customers was unfair (68 percent) rather than fair (29 percent). On the question of permitting overdrafts without any notice at the ATM, an overwhelming majority (82 percent) said that this practice was unfair, with 63 percent saying it was "very unfair." Only 17 percent said it was fair.

Vulnerable Consumers Are Most Affected

Bounce loan fees are mostly generated from a small minority of customers, who are among the most vulnerable of consumers. The ORCI poll asked consumers about their own experiences with overdrafts and found that 28 percent of consumers said they had bounced at least one check in the past year. Of these consumers, about two-thirds said they had bounced

[13]Interagency Proposed Overdraft Protection Guidance, OCC Docket No. 04-14, OTS No. 2004-30, Federal Reserve System, Docket No. OP-1198, FDIC and NCUA

[14]Indiana Department of Financial Institutions, Newsletter - Winter 2002 Edition (Nov. 2002), at 2, Clearinghouse No. (D/E: Fill in number); Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001 (in response to referral from the Administrator for the Colorado Uniform Consumer Credit Code).

[15] Laura K. Thompson, *Lending Rule Won't Apply to Overdrafts*, American Banker, May 28, 2004.

only one or two checks, while the remaining one-third said they had bounced at least three checks. In surveys, consumers typically underreport the frequency with which they bounce checks.

The CFA survey revealed that moderate-income consumers with household incomes of $25,000 to $50,000 (37 percent), those 25 to 44 years of age (36 percent), and African Americans (45 percent) were most likely to have overdrawn their accounts. Twenty-two percent of the lowest income group surveyed, making less than $25,000 a year, and less educated consumers (33 percent) reported that they do not have a bank account.

A third party vendor who promotes bounce loans has said that about 15 percent of customers incur bounce loan fees.[16] A study by the Washington State Department of Financial Institutions reveals over 20 percent of borrowers who incur bounce loan fees are charged such fees two or more times per month.[17] According to another bounce loan vendor, 4 percent of bounce loan customers are responsible for 50 percent of loan fees.[18]

Financial Institution Marketing of Bounce Loans

The Consumer Federation of America conducted a review of the websites of 50 financial institutions to assess the current state of advertising and disclosures of this product. The results show that, despite over a year and a half of controversy surrounding this loan product,[19] and the announcement of the proposed Interagency Guidance months before the survey, many financial institutions continue with "business as usual" for bounce loans.[20]

CFA's review examined both advertisements and the Policy/FAQ/ fine print sections of websites (hereinafter "Policy/FAQ disclosures"). Out of 50 websites, 41 of them contain advertisements for bounce loan programs, while 23 contained Policy/FAQ disclosures. Over one third (34 percent) of the advertisements contained language that encouraged customers to overdraw their accounts, using statements about "running short on cash between paydays" or "checking account running a little thin?" One advertisement even touted bounce loans as an "excellent alternative to expensive payday lending loan or check cashing outlets."

Many of the websites also made contradictory statements suggesting guaranteed coverage, using themes of "we've got you covered" or "peace of mind," while downplaying the "discretionary" aspects of the program that were disclosed. Over half (54 percent) of the advertisements promoted the guarantees of coverage more heavily than the discretionary nature.

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[16] Paul Gentile, *With Fed Electing Not to Treat Overdrafts as Loans, Door Wide Open for Continued Growth in CU Industry*, Credit Union Times, June 23, 2004 (quoting Bill Strunk of Strunk & Associates).
[17] Washington Department of Financial Institutions, *Overdraft Protection Programs* (September 19, 2003) at p. 4, available at http://www.dfi.wa.gov/Legislative percent20report.pdf
[18] Alex Berenson, *Some Banks Encourage Overdrafts, Reaping Profit*, New York Times, Jan. 22, 2003.
[19] Consumer Federation of America & National Consumer Law Center, Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks (Jan. 27, 2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.

The review of bounce loan advertisements and Policy/FAQ disclosures also found that institutions did not provide vital information about the requirements and terms of bounce loans. These omissions are especially problematic given there is no common understanding of how these programs operate that a reasonable consumer could be expected to know. For example, only 39 percent of the advertisements and only about a quarter (26 percent) of the Policy/FAQ disclosures revealed the specific dollar amount of the bounce loan/overdraft fee. Only 39 percent of both advertisements and disclosures informed the customer about the expected repayment schedule for bounce loans.

Truth in Lending Should Apply to Bounce Loans

Bounce credit fees clearly meet Regulation Z's definition of finance charge. Section 226.4(c)(3) of Regulation Z, which excludes fees for traditional overdrafts, provides that overdraft fees are finance charges when "the payment of such items and the imposition of the charge were previously agreed upon in writing." Although banks offering bounce credit have sought to avoid Regulation Z's coverage by claiming that the bank's payment of an overdraft in a "bounce protection" plan is "discretionary" and that such payments have not been agreed to in writing, these assertions are not supportable. First, bounce credit is not discretionary. These plans are administered through computer software and thus are formal, systematic programs rather than an occasional customer courtesy. Moreover, banks extend bounce credit pursuant to an agreement in writing, whether through advertisements, correspondence, or on a website. Consumer assent is not necessary, and consumers often are held accountable for fees unilaterally imposed by banks.

An APR disclosure and TILA coverage is critical for bounce loans. Without it, consumers have no way to compare the cost of other similar credit transactions, such as payday loans, pawnbroker loans, auto title loans, overdraft lines of credit, and credit card cash advances. Under the Board proposal, the disclosed APR for a typical payday loan is 391 to 443 percent[21] but for a bounce loan the lender may disclose under TISA that the account is actually earning interest! Without apples to apples comparisons, there is no competition to reduce the cost of any of these products.

Consumers do find APR disclosures useful. Several studies have found that an ever-increasing number of consumers know about and rely upon APR disclosures. The percentage of consumers aware of APRs increased from 27 percent in 1968 to over 80 percent in 2001.[22] The percentage of consumers that read TIL disclosures carefully increased from 27 percent in 1977 to nearly 50 percent in 2001.[23] Moreover, 60 percent of consumers surveyed in 2001 agreed that TILA disclosures are helpful.[24] Over two-thirds of consumers think that the APR is an important item of information about credit terms.[25]

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[21] Keith Ernst, et al., *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (December 18, 2003), at 3.
[22] Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, Fed. Res. Bull. 201, 207 (Apr. 2002).
[23] *Id.* at 208 (Table 9).
[24] *Id.*
[25] *Id.* at 203.

Abandoning the principles of TILA is particularly ill-advised in the case of bounce loans. If a loan product carries a low APR, such as 3 percent, consumers will not be significantly harmed by entering into a loan transaction unaware of the APR. Bounce loans, however, carry effective APRs in the triple digits. The Board's failure to require TILA disclosures for bounce loans means that consumers are likely to enter into these abusive, extraordinarily expensive transactions while unaware of their costs.

Further, by allowing bounce loans to be made without APR disclosures, the Board proposal misses an opportunity to increase rate competition in the segment of the consumer credit market where it is most desperately needed - the market for subprime small loans. The entry of bounce loan lenders into this market has the potential of creating more rate competition and placing downward pressure on the exorbitant rates consumers pay. However, if banks are allowed to offer bounce loan credit without making the disclosures that other lenders must make, consumers are deprived of the ability to compare bounce loans to other products. Without even-handed regulation of banks and other small loan lenders, the opportunity to enhance competition will be lost. Refusing to require APR disclosures for bounce loans means abandoning low-income consumers to the worst elements of the consumer credit market.

Application of TILA's substantive restrictions on credit cards will go a long way in addressing one of worst aspects of bounce loans – that consumers are extended these loans without their affirmative assent, and sometimes even without their knowledge that this product is attached to their accounts. TILA's special credit card provisions include: (i) a prohibition against the unsolicited issuance of credit cards[26] and (ii) a prohibition against set-off of a deposit account unless the consumer affirmatively consents separately in writing to either a security interest taken in the account or to an automatic payment plan.[27] These special credit card provisions apply whether or not a finance charge is imposed.

Instead of discouraging overdrafts and encouraging sound financial management, these banks are now encouraging consumers to use high-cost credit. By permitting overdrafts, not just through checks but ATMs and debit cards, a growing number of banks are creating new ways to impose exorbitant fees and create financial hardship. If the Federal Reserve fails to require financial institutions to comply with Truth In Lending's open-end credit rules, Congress should amend TILA to make it clear that all lenders must tell consumers the accurate cost of the money they borrow.

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[26] TILA, 15 U.S.C. § 1642; Regulation Z, 12 C.F.R. § 226.12(a); Official Staff Commentary § 226.12(a)(1)-2 (addition of overdraft privileges on a checking account with a check guarantee card constitutes issuance of a credit card). It is true that Regulation E governs issuance of an access device that permits overdraft credit extensions; however that provision applies when there is a *preexisting agreement* between a consumer and a financial institution to pay overdrafts. Reg. E, 12 C.F.R. 205.12(a)(ii). If the Board allows bounce loan fees to be exempted from finance charge treatment, it is essentially stating there is no pre-existing agreement. In that case, Regulation Z would govern issuance.

[27] TILA, 15 U.S.C. § 1666h, Regulation Z, 12 C.F.R. § 226.12(d); Official Staff Commentary § 226.12(d)(1)-3 (specifically applying rule against offsets to overdraft credit).

C. Refund Anticipation Loans secured by EITC benefits, tax refunds

Refund anticipation loans (RALs) are high cost loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs only last about 10 days, fees for these loans translate into triple digit annualized interest rates. RALs drain billions from the pockets of consumers and the U.S. Treasury. They are targeted at the working poor who receive the Earned Income Tax Credit (EITC), a refundable credit provided through the tax system and intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, with over $36 billion provided to over 20 million families last year.[28]

Consumers paid an estimated $1.14 billion in RAL fees and an additional $406 million in "administrative" or electronic filing fees in 2002 to get quick cash for their refunds. RAL volume increased moderately from 2001 to 2002, with approximately 12.7 million RALs taken out during the 2002 tax-filing season, compared to 12.1 million in 2001.

The effective annualized interest rate for RALs based on a 10 day loan period ranges from about 70 percent (for a loan of $5,000) to over 700 percent (for a loan of $200), or 94 percent to 1837 percent if administrative or "e-filing" fees are included. Tax preparation chains and RAL lenders have been reporting lower Annual Percentage Rates (APRs) by "unbundling" charges from the loan fees. These APRs give a less accurate picture of the true "cost of credit" for RALs.

Over half of RAL consumers are recipients of the Earned Income Tax Credit (EITC), despite the fact that EITC recipients only constitute 15 percent of all taxpayers. RALs siphoned off an estimated $749 million in loan fees and administrative/electronic filing fees from low-wage workers who receive the EITC. If tax preparation fees are included, the total estimate rises to $1.59 billion paid by EITC recipients Check cashing fees for 45 percent of these EITC recipients add another $161 million, for a total estimate of $1.75 billion spent by the working poor to get less than two weeks quicker access to this government benefit distributed through the tax system.

The Internal Revenue Service (IRS) continues to tacitly promote RALs by providing the Debt Indicator, which uses taxpayer data to screen loan applicants for tax refund offsets. The IRS also continues to permit commercial tax preparers to market RALs and other paid products through the IRS Free File program.

The number of partnerships between tax preparers and high-cost fringe financial service providers has increased. In addition to check cashers, commercial preparation chains now partner with rent-to-own companies and purveyors of costly stored value cards.

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[28] National Taxpayer Advocate, *FY 2003 Annual Report to Congress*, December 31, 2003, at 27.

Recommendations to Protect Taxpayers from RAL abuses:

- Prohibit cross-lender debt collection in RALs, through which RAL bank partners repay past loans from current year tax refunds, acting as debt collectors for each other.
- Halt the IRS Debt Indicator, a service provided to RAL lenders by the IRS which checks for other claims on the taxpayer's tax refund and passes this taxpayer information on the to the bank involved in the RAL. This is information available to no other commercial entity.
- Enact a federal cap on RAL rates. Failing that, make RALs subject to state usury and small loan interest rate laws. Enforce any existing loan broker statutes against tax preparers who facilitate RALs.
- Prohibit tax preparers from referring consumers to commercial check cashers, rent-to-own stores, or other high-priced financial services.
- Require tax preparers to be licensed and have minimum qualifications. State and federal regulators should address whether car dealers, check cashers, and payday lenders engaged in tax preparation are doing so competently and correctly.
- Require RAL lenders and tax preparers to include all of the costs of a RAL in the Truth in Lending disclosures, including any "dummy" account, administrative, electronic filing, or document preparation fees. RAL lenders should be prohibited from disclosing misleading APRs by subtracting out or "unbundling" charges.
- The Department of Treasury can provide bank accounts for EITC recipients who file their taxes electronically in order to receive direct deposits of refunds without having to purchase a RAL. Bank partnerships with free tax assistance programs can provide free or low cost savings accounts that remain open all year.
- Rethink the Congressional 2007 deadline for achieving an 80 percent electronic filing rate, since achieving that goal is being borne by lower income taxpayers who pay for commercial tax preparation and RALs.

II. Restrict Deceptive and Abusive Credit Card Practices - Interest Rate "Bait and Switch"

Our organizations have commented at length elsewhere about the need for regulatory and legislative measures to curb abusive and deceptive lending practices by credit card issuers. As interest rates have dropped in the last few years, issuers have resorted to a number of questionable business practices to prop-up interest income and to boost fee income. We urge this subcommittee to take a comprehensive look at the many traps, tricks and "gotchas" that issuers use to unjustifiably pad their profits. These include:

- **Deceptive and abusive fee and interest rate practices,** such as: average late fees of $31 (according to CardWeb.com), even to those who might only be one day late with a payment; the ever-shrinking period of time between when issuers mail a bill and when payment is due; disproportionate penalty interest rates of 30 percent that apply retroactively to a consumer's balance; and "fixed" interest rates that can be changed with as little as 15 days notice.

- **Inadequate disclosure.** Some issuers continue to try and hide the real costs of credit. For example, a number of credit card companies have been repeatedly criticized for inadequately

disclosing the fees and higher interest rates they charge consumers that they allow to exceed their credit limit. In another example, MBNA attempted in early 2003 to hide information on the total balance owed by their customers by moving this figure from a prominent location on the top of the bill, to the bottom. MBNA backtracked after being publicly criticized for this step. Issuers have also fought state and federal requirements for effective disclosure to consumers on their billing statements of the length of time it would take to pay off their balances and the minimum payment rate, and the total costs in interest and principal if they did so.

- **Mandatory arbitration**. Many credit card contracts contain pre-dispute mandatory arbitration as a requirement, to prevent consumers from exercising their legal rights in court.

- **Aggressive and deceptive marketing of credit insurance** and other product "add ons" of very little value.

- **Failure to pass along interest rate reductions**, through rate "floors" in credit card contracts and other means.

Perhaps the single most abusive of these traps involves increasing consumers' interest rates on existing balances based on a decline in their credit scores. Creditors call this practice "risk-based re-pricing." Consumer organizations call it "bait and switch." It has been the subject of a number of critical and high-profile articles in the *New York Times* and other leading media outlets recently.

Last year, for example, the *New York Times* reported that three-quarters of all card issuers have given themselves the right to abruptly increase interest rates to as high as 30 percent based on a decline in a credit score or minor delinquencies with another creditor, even if the consumer has made no late payments or missteps with the card in question.

This arbitrary, punitive and counter-productive practice must be banned. It is simply not a fair business practice to suddenly double an agreed-upon interest rate for consumers who are paying their bills on time. If creditors were truly concerned about their financial exposure to customers who are becoming increasingly risky, as they claim they are, they would move to cap consumers' credit limits, not jack up their interest rate on previous purchases. For consumers whose credit scores have dipped by just a few points, this is an unjustifiable violation of the financial terms to which creditor and consumer have previously agreed; an unscrupulous attempt to increase interest income at the consumers' expense. For consumers who might truly be in financial trouble (and are having significant trouble paying their other creditors) such a move is likely to increase their financial risk by requiring them to pay significant new charges. Moreover, as reported by the Consumer Federation of America in its study on credit scores in December of 2002[29], there are significant and unexplained credit score variations that occur between credit bureaus for the same consumers. There are still too many questions about the

[29] http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf

accuracy and completeness of credit scores for creditors to be using them as the basis of such a significant change in terms.

III. Proliferation of Plastic, Lagging Protections

Individuals are increasingly being asked to accept stored value cards to receive payments of funds that are essential for day to day family expenses. These cards should offer the same level of consumer protections as those bank debit cards that are linked to individual consumer checking accounts. These cards, sometimes called stored value cards, are increasingly targeted to those not using traditional deposit accounts. Stored value cards include payroll cards, prepaid cards sold to individuals for Internet and in-person card use, cards used to deliver income tax refund monies or income tax refund loan proceeds, child-support cards, and cards used to draw unemployment payments.

Payroll cards, one form of stored value card, are increasingly offered to low- and moderate-wage workers. These products are being marketed to workers as serving the same functions as a bank account even though present law is at best unclear about whether these cards carry the same federal consumer protections that apply to bank debit cards linked to an individual deposit account.[30]

A recent publication of the Federal Reserve Board highlights the risk for consumers of stored value cards in the absence of EFTA consumer protections. In the Winter 2004 Bulletin, an article by Federal Reserve staffers states:

> Products Not Related to Bank Accounts
>
> Electronic products that are not tied to a consumer bank account but instead store monetary value in a related database or on a card include prepaid cards (such as phone and gift cards), payroll cards, college and military cards, cards used to deliver insurance benefits to disaster victims, and cards used by states to deliver child support payments. These cards can look much like traditional debit cards (for example, they may carry a MasterCard or Visa logo) and may even be called debit cards by merchants and vendors.

The article continues, in a box titled: "E-Banking and Consumer Protection":

> ...Generally, electronic fund transfer products not associated with a consumer bank account, such as stored-value cards, are not covered by the EFTA.[31]

[30] For information discussing the issues and risks of payroll cards for employees and employers, as well as the ways in which these products could be enhanced to build a stronger bridge to financial security and fuller access to the banking system for unbanked workers, See:
http://www.consumersunion.org/pub/core_financial_services/000920.html, March 16, 2004 and
http://www.consumersunion.org/pub/core_financial_services/000922.html, March 16, 2004. A key issue highlighted in that material is the potential for a higher level of risk of loss or theft of funds accessible through the card than is present for consumers who hold a debit card linked to a traditional, individual bank account.
[31] *U.S. Consumers and Electronic Banking, 1995-2003*, Federal Reserve Bulletin, Winter 2004, pp. 3-4.

To make payroll cards and similar stored value cards a valuable stepping stone into the banking system, rather than an inferior product, we have called on the Federal Reserve Board to ensure that these cards have at least the same protections that apply to ordinary debit cards and to clarify that federal Regulation E fully applies to stored value cards, including payroll cards, regardless of whether the funds are held in an individual or a pooled account, and regardless of how the accounting is performed for these cards.

A payroll card looks like a bank debit card, but it can be linked to an account held in the name of the employer, with or without individual sub-accounting by the issuer. The employer's bank may transfer the payroll funds for all employees using the cards into a single account, and all the payroll cards for that employer may pull funds from that one account. It is also possible to set up the cards with individual accounts for each employee. When an individual account structure is not used, there are questions about the application of federal Regulation E. The OCC has identified Regulation E coverage as a key unsettled issue, stating in a May 2004 advisory letter to national banks: "There are a number of unsettled regulatory issues involving payroll cards including ... whether Regulation E applies to payroll card systems...."[32]

We have asked the Federal Reserve Board to issue an interpretation determining that all payroll card programs and similar stored value card programs - including card programs using a pooled account in which funds paid by, on behalf of, or for payment to, a number of individuals - qualify as a "consumer asset account" under Regulation E and therefore that cardholders are entitled to the protections of the federal Electronic Fund Transfer Act, including liability limits and error resolution rights, such as the right to a ten business day recredit of funds removed in a disputed transaction.

Lower wage workers who are paid by payroll card, single-parent households receiving child support payments distributed by stored value card, and persons receiving unemployment payments through a state benefits card are the very households who can least afford to be deprived of funds, or delayed access to funds, due to a theft or an unauthorized transaction using the consumer's card. These funds are needed to pay rent or a mortgage, buy food, and pay bills. As the OCC told national banks earlier this year about payroll cards: "The systems hold what are, for the individual consumers, important amounts of money -- their payroll." OCC Advisory Letter AL 2004-06.

A delay in access to funds or a loss of funds due to non-application of the protections of the Electronic Fund Transfer Act could trigger eviction, a black mark on a credit record, and hungry children. Lower income families simply do not have the assets to cushion against even a temporary interruption of funds. In the year 2000, significant numbers of U.S. households had negative or zero net worth, including 27.6 percent of Hispanic households, 29.1 percent of Black households, and 11.3 percent of White Non-Hispanic households. An additional 6.7 percent; 7.3 percent; and 4.7 percent of these households respectively had net worth ranging from $1 to

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[32] OCC Advisory Letter AL 2004-06, May 6, 2004.

$4,999, even when including equity in the family car.[33] These families simply can't afford to be without access to their funds because of a problem with a payroll card, child support card, or unemployment benefits card.

These cards are a growing business. Payroll cards are being actively marketed to employers as a way to reduce the costs of handling paper checks for employers and as a way to serve the needs of the millions of U.S. households who do not currently have bank accounts. A study issued by the Office of Comptroller of the Currency reported that 10 percent of unbanked households, representing 1 million families, were using payroll cards at the end of 2002.[34] Usage has grown dramatically since then. In May 2004, the Associated Press reported that 1,000 companies were using payroll cards in the U.S., distributing $11 billion annually in payroll and $4 billion annually in employee incentive or commission payments.[35] In that same story, a VISA spokesperson claimed "triple digit growth rates for this category." AP cites the Mercator Advisory Group for an estimate that the potential U.S. market for payroll cards for unbanked, temporary, and remote location workers is $109.8 billion.

Now is the time for the Federal Reserve Board or Congress to act to prevent payroll cards and other stored value cards delivering funds to families from becoming another inferior, "second-tier" product for persons lacking a bank account. We believe that the Federal Reserve Board has the power to interpret the requirement in Regulation E of a "consumer asset account" as satisfied by a pooled account holding funds upon which cardholding consumers are entitled to draw. Such an account holds assets owed to consumers even if it is not held in the name of the individual consumer. Without such an interpretation, unbanked consumers are offered a significantly inferior product and face significantly higher risks when they accept a payroll card, child support card, or similar stored value card—an electronic payment mechanism that lacks the baseline consumer protections available to other debit-based electronic payment mechanisms, that is, the protections of the Electronic Fund Transfer Act (EFTA).

The FDIC has taken an initial step in response to this significantly expanding market by addressing an issue within its jurisdiction – deposit insurance for stored value cards. The OCC has warned national banks that there are significant unsettled issues, including the application of the EFTA. The next step is up to the Federal Reserve Board. The Federal Reserve Board should interpret Regulation E so that the consumer protections of the Electronic Fund Transfer Act apply to the expanding market of stored value cards, particularly payroll cards, prepaid debit cards, child support cards, unemployment cards, and cards used to distribute employee benefits.

Payroll cards and other forms of stored value cards offer the promise of bringing persons not using traditional banking products into the electronic payments mainstream, but that promise cannot be fulfilled if these cards have absent, ambiguous or inferior consumer rights and protections. These plastic payment cards can also be exceptionally expensive. For example, the

[33] B. Robles, *Economic Opportunity: Family Assets*, June 2003, a report prepared for the Annie E. Casey Foundation, www.utexas.edu/lbj/faculty/robles/research.
[34] *Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked*, OCC Community Development, October 2003.
[35] *New Payroll Cards Sub for Paychecks*, Associated Press Online, May 31, 2004.

fees for the new "Usher Raymond IV Debit MasterCard" include $3.95 for each additional "value load", $2.00 Cash Withdrawal Fee, $1.50 for each Balance Inquiry, a $4.95 Monthly Maintenance Fee, a $15 Card Activation Fee and $9.95 to replace a lost card. Every time the Usher card is used to purchase something costs one dollar. Shipping and handling adds $3.95. If you overdraw the card balance, a $5 fee will be assessed for each transaction that exceeds available funds. To speak to a live person about a problem with your account costs $1.50 a minute. And if you want the balance on the card transferred to you by check, a Balance Reimbursement Fee of $9.95 is deducted.[36]

Regardless of whether the Federal Reserve expands Reg E to cover some forms of stored value cards or the FDIC applies deposit insurance to pooled payroll card accounts, Congress should take action to expand protections consumers take for granted for debit and credit cards to apply to emerging payment products. The model Stored Value Card Act, drafted by the National Consumer Law Center, is the place to start.

IV. Other Credit Issues Impacting Consumers

A. Protect Consumers from unfair, deceptive and over-reaching Debt Collectors

There are a number of formal and informal legislative proposals floating around this Congress that would seriously undermine the consumer protections of the Fair Debt Collection Practices Act. This would be a mistake, especially without comprehensive hearings to consider all sides of the complicated questions facing consumers in the debt collection process.

The FDCPA does nothing to prevent the collection of a valid debt. It only prohibits debt collectors from inappropriate activities in the collection of those debts. The law establishes general standards of proscribed conduct, defines and restricts abusive collection acts, and provides specific rights for consumers. Collectors cannot harass consumers or invade their privacy, make false or deceptive representations, or use abusive collection tactics. Specific acts that are prohibited include late night or repetitive phone calls and false threats of legal action.

Studies have shown overwhelmingly that consumers generally fall behind on their debts because of a serious illness, a death in the family, or the loss of a job. Very few consumers deliberately avoid their debts when they have the ability to pay them. The recent recession cost millions of Americans their jobs, resulting in more consumers struggling to pay their bills. It is especially essential that the basic consumer protections in the FDCPA not be undermined.

In this testimony we address two anti-consumer proposals on debt collection. One is H.R. 3066, the other is a proposal to exempt check diversion companies from coverage of the FDCPA.

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[36] www.ushermc.com/faz/faz/html, visited 8/16/04. Cardweb.com/cardtrack/news/2004/July/30a.html stated "R&B artist Usher Raymond IV has given his blessing to a new MasterCard targeted at unbanked Americans."

H.R. 3066 would hurt consumers. This legislation would significantly reduce consumer protections in seven important areas:

Section 2. This provision would make much of the FDCPA inapplicable to legal pleadings. The collectors claim this is necessary to protect them from compliance with conflicting laws, so that they will not be required to include the notice of the right validate a debt (required by 15 U.S.C. § 1692g(a)) on legal pleadings. The collectors neglect to mention, however, that there have been no lawsuits on this point. More importantly, the amendment goes far beyond simply deleting the requirement for the validation notice on pleadings. It would immunize collectors who violate other important provisions of the FDCPA in formal pleadings, such as when they sue for more than is actually owed by the consumer; or obtain default judgments even after settling the case with the consumer. Moreover, this provision would do away with the informal debt validation procedure if the debt collector initiates contact by filing suit. This will force consumers to raise disputes in court when they could have been settled informally. Yet many consumers who are unable to represent themselves in court will find themselves subject to garnishments and seizures of assets for debts they never owed.

Section 3. This section would codify a verbose and difficult to read validation notice instead of a notice that simply tells consumers that they have a right to require the collector to verify a disputed debt. The notice proposed in Section 3 is used frequently in current collection letters, and is far from a model of simple language that Congress should endorse for a consumer notice. The proposed notice requires consumer education efforts that could be easily avoided by the use of simpler words and sentence structure.

Section 4. This section would add a statement in the statute's debt validation provision that a debt collector may engage in collection activities during the 30-day period that a consumer may request the debt to be verified by the collector. Since that is already allowed by both existing case law and an FTC formal advisory opinion, this amendment can only be viewed as an attempt to reduce the current law's requirements that the notice of the debt validation right not be rendered ineffective by debt collection threats that are either confusing or overshadow the notice of validation rights. Unless its intent is clarified, this amendment will simply stimulate litigation about its meaning. If it is intended to sanction efforts to obscure the debt validation right, it will diminish an essential consumer tool designed to avoid mistaken collection efforts that waste the time of consumers and collectors alike.

Section 5. Currently, two provisions of the FDCPA shield represented consumers from duns as long as the collector knows of their legal representation and the consumer's lawyer responds to collectors within a "reasonable" time. (15 U.S.C. §§ 1692b(6), 1692c(a)(2)). Section 5 of the bill would shield only a consumer represented by an "attorney at law" and replace the reasonable time requirement with a 30-day requirement. These amendments seem to be targeted at preventing the attorney's employees from preparing responses to debt collector inquiries, creating unnecessary drain on consumer attorney resources.

Section 6. The FDCPA currently requires a debt collector to stop requesting payments from the consumer once the consumer tells the debt collector to stop contact. Current law then

permits the collector to notify the consumer only that the collector is terminating its collections, to explain the collector's ordinary remedies, or to state that the collector's remedy will be pursued. The existing protection gives consumers a respite from dunning calls and letters, without preventing the communication of real consequences which consumers need to know. However, Section 6 of this bill would restrict the debt collector to one notice to the consumer even if they are pursuing multiple remedies at different points in time. It's difficult to understand what interest is served by this proposal.

Sections 7 and 8. These sections would amend the FDCPA to require that the consumer send a written statement disputing the debt before the debt collector would have to pay attention to the dispute. These amendments would make it legal for a debt collector to actually ignore the consumer's telephone statements contesting the validity of the debt, requiring consumer disputes to be raised in writing before they will be considered by debt collectors. The collector would be permitted to presume the debt is valid even if it is disputed orally. The collector could threaten to report an orally disputed debt to a credit reporting agency as if it was uncontested. Collectors would be entitled to threaten the consumer: "I don't care what you say about fraud, having paid the debt, or identity theft; if you don't put a check in the mail today, we will ruin your credit." It's difficult to believe that this amendment has been introduced in a Congress that has repeatedly expressed its strong concern with the increasing crime of identity theft and telephone frauds!

Millions of American consumers would be considerably harmed if this misguided bill were to become law. H.R. 3066 weakens the substantive and procedural protections of the FDCPA.

We also urge you to resist the efforts of check diversion companies to obtain an exemption from the Fair Debt Collections Practices Act ("FDCPA."). If this exemption is granted, hundreds of thousands of innocent American consumers will pay unnecessary and unauthorized charges to these for-profit companies in response to deceptive threats to criminally prosecute them for writing bounced checks.

Check diversion companies are debt collectors which enter into contracts with District Attorneys to collect bounced checks for local merchants. These companies send letters on the DA's letterhead threatening criminal prosecution if the consumer does not attend a "financial responsibility" class, and pay high extra fees for these classes. Many consumers have been deceived by these companies into believing that if they did not pay these extra fees they would be criminally prosecuted, even when no prosecutor had ever determined that a crime had been committed, and the local prosecutor would never actually prosecute.

FDCPA does not stop or inhibit the legal activities of check diversion companies. In fact, most collectors of bounced checks operate fruitful businesses while fully complying with the FDCPA. However, check diversion companies are so profitable that they share their income with the DA's office, providing funds to this government office rather receiving money from it to perform a governmental function. Yet, in these check diversion programs the DAs have not done any investigation to determine the critical requirement of the crime – an intent to defraud. Indeed most of these consumers have not intended to defraud, and quickly pay off the checks upon

receiving notice. As a result, many consumers who have inadvertently bounced small checks are deceived into paying as much as $140 extra to avoid a criminal prosecution which would never occur if the DA were actually handling the case. Indeed, regardless of the involvement of the for-profit check diversion program, the majority of bounced check cases are not criminally prosecuted because there is no intent to defraud, a required element of the crime.

The FDCPA only limits the activities of check diversion companies in its requirements that no deception be committed, that consumers be advised of their right to request validation of the debt, and that only authorized fees be collected. These are requirements that all debt collectors collecting bounced checks are able to comply with and still successfully collect. Specifically, check diversion companies have consistently been found liable by the courts, or have settled cases alleging three types of illegal conduct:

- **Deceptive Behavior.** The check diversion companies' letters to consumers were deceptive because they looked like they actually came from the District Attorney and implied that the DA had determined the consumer had committed a crime. In fact no DA ever reviews cases before the letter threatening criminal prosecution is mailed. In many situations, if the DA had reviewed the case, no intent to defraud would have been found, and no criminal prosecution would have been threatened.

- **Failure to Provide Notice of the Right To Verify the Debt.** Unlike all other private debt collectors collecting debts, including bounced checks, the check diversion companies refuse to provide notice to consumers that they have the right to request verification of the debt. In many situations this right would allow consumers to explain that they have already paid off the check, or do not believe they owe it.

- **Attempted Collection of Illegal Fees.** Generally, state laws specifically provide the extra fees that consumers owe when they write a check that bounces. Often the courts can impose monetary penalties after a conviction for writing a bounced check (which must include a finding of intent to defraud). Yet the check diversion programs insist upon the payment of these fees even when no court has found - or would find - the consumer guilty of bouncing a check. For consumers, this often turns a mistake of a $10 or $20 bounced check into a cost approaching $200.

The majority of District Attorneys in the nation do not use check diversion companies, finding alternative, far less abusive, ways to enforce laws against writing checks that bounce for insufficient funds. Many DAs use dispute settlement programs to resolve bounced check issues between merchants and consumers. Other DAs simply write their own letters explaining the process to consumers. These letters do not require the payment of the exorbitant additional fees charged by the check diversion companies, they simply advise of the process involved when a payee of a check that has bounced brings the case to the criminal court. These DAs find that even without employing private companies which make millions of dollars in profit from consumers who have inadvertently bounced a check, only a very few cases are criminally prosecuted.

Check diversion companies do not need an exemption from the FDCPA. They can operate profitable, effective businesses without this exemption, simply by complying with the law. This would only mean that 1) the check diversion company not imply that the DA has reviewed the consumer's case and found that a crime has been committed, unless the DA has done so; 2) the letter to the consumer includes the required notice of the consumer's right to request validation of the debt; and 3) the company only collect fees that can be legally charged.

The Fair Debt Collection Practices Act does not inhibit the collection of debts; it only prohibits deception and abuse, and requires that consumers be allowed an opportunity to show they do not owe the debt. These requirements are appropriate and necessary for private individuals who are collecting debts - whether they are acting for private creditors or government officials. As Congress determined when passing the FDCPA, once the incentive of profit is injected into the collection effort, more protections are required.

We urge you to resist the effort of one small part of the collection industry to evade compliance with the Fair Debt Collection Practices Act. Bounced checks can be collected quite effectively by collectors complying with this important consumer protection law.

B. Make the EGRPRA process fair to consumers

Currently all of the federal supervisory agencies are jointly engaged in the process of reviewing laws and regulations affecting depository institutions to determine updates and necessary changes pursuant to the Economic Growth and Paperwork Reduction Act of 1996.[38] We are very concerned that this process will yield results that inappropriately favor industry over consumers.

A fair review cannot be limited to issues that favor those institutions. A full and fair analysis of appropriate updates for the regulations and laws must include proposals to benefit consumers. The Economic Growth and Paperwork Reduction Act simply requires the regulatory agencies to review regulations and laws:

> "...in order to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions."[39]

To date, all of the written materials accompanying the request for comments regarding the rules display the agencies' unfortunate bias towards evaluating regulations and federal statutes *only* from the perspective of the financial institutions. Every single one of the questions posed to the participants in the focus groups to discuss this review reveals this skewed evaluation. To be fair, and to accomplish the overall goal of EGRPRA, and of underlying purposes of the regulations, the agencies must broaden their perspective, and include a full evaluation of *the impact on consumers* of all proposed changes.

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[38] 12 U.S.C. § 3311.
[39] 12 U.S.C. § 3311(a).

We have filed extensive comments with the agencies regarding the consumer positions in the EGRPRA process.[40] We ask that the House Subcommittee instruct the agencies to ensure that their recommendations will be fair and protective of consumers.

C. Stop the OCC From Preempting State Laws

Important unfinished business by the Committee includes the need for action to curb the sweeping preemption rules adopted by the Office of the Comptroller of the Currency (OCC). These regulations have the effect of over-riding state consumer protection laws that formerly applied to national banks and their state-licensed non-bank operating subsidiaries. We praise Chairwoman Kelly and her Subcommittee on Oversight and Investigations for holding hearings earlier this year that raised profound questions about the legitimacy of the OCC's actions and whether the new rules correctly interpreted Congressional intent. Reps. Gutierrez and Paul and 28 original co-sponsors subsequently introduced Congressional motions of disapproval, H.R. 4236 and 4237, intended to overturn the OCC's over-reaching rules. We and other consumer and community organizations have written committee members voicing support for consideration of these resolutions. Unfortunately, the full Committee has not scheduled mark-ups on them. We strongly urge that such actions be taken before the close of the Congressional session.

D. Rent To Own Abuses

Rent-to-own is another credit transaction pretending to be something else to avoid consumer protections. These are essentially appliance and furniture retailers, which arrange lease agreements instead of the typical installment sales contracts for customers who cannot purchase goods with cash or who are unsophisticated about money management. The lease agreements are short term so that "rental payments" are due weekly or monthly and contain purchase options that typically enable consumers to obtain title to the goods by making an additional payment at the end of a stated period, such as eighteen months. The leases are "at will," and theoretically need not be renewed at the end of each weekly or monthly term.

Marketing of rent-to-own is targeted at low-income consumers by advertising in minority media, on buses, and in public housing projects. FTC statistics show that the RTO customer base is among the poorest, and that the vast majority of their customers enter into these transactions with the expectation of buying an appliance and are seldom interested in the rental aspect of the contract. RTO dealers emphasize the purchase option in their marketing while minimizing its importance in the written contract.

The chief problems with RTO contracts are that these supposed leases are used to mask installment sales, and that these sales are made at astronomic, and undisclosed, annual percentage rates. Under most RTO contracts, the customer will pay between $1,000 and $2,400 for a TV, stereo, or other major appliance worth as little as $200 retail, if used, and seldom more than $600 retail, if new. This means that a low-income RTO customer may pay one and a half to

[40] http://www.federalreserve.gov/SECRS/2004/April/20040427/R-1180/R-1180_462_1.pdf

twelve times what a cash customer would pay in a traditional retail store for the same merchandise.

We oppose H.R. 996, the Consumer Rental-Purchase Agreement Act of 2003, which pretends to protect consumers but does no such thing. Instead, the bill preempts the state laws providing the strongest protection for consumers, including state laws of Wisconsin, Michigan, Minnesota, Vermont, North Carolina, and New Jersey. We continue to urge Congress not to overturn state laws that prevent predatory financial practices. A cursory reading of the bill might lead one to believe that some of the provisions would actually help consumers, but a close evaluation reveals that there are no meaningful protections whatsoever in this bill. Even the one provision that comes closest to requiring some helpful information to consumers (Section 1010) has such weak penalties attached that dealers will have no incentive to comply.

Year after year the rent-to-own industry brings legislation to Congress that pretends to protect consumers but in fact merely seeks to preempt stronger state legislation. We urge you to oppose H.R. 996 and to send a strong message to the industry that you will not weaken protections for the poorest and least credit-savvy consumers.

E. Simplify Rules as Check 21 is Implemented

Payment methods are increasingly converging, but the consumer rights available differ vastly depending on how the payment was processed. A consumer who pays by debit card, for example, has the protections of the federal Electronic Fund Transfer Act, including a 10 business day right of re-credit of all disputed funds. The consumer never has to be without his or her funds for more than 10 business days when paying by electronic debit. When a consumer pays by check, however, the applicable consumer rights are much more murky. A paper check, or a check which is processed wholly electronically under bank-to-bank image exchange agreements, is subject to the Uniform Commercial Code and carries no baseline federal consumer protections.

Even though image exchange is an electronic processing method, the EFTA exemption for checks means that consumers don't get the crucial 10 day right of re-credit, and thus are at the mercy of their banks or the courts to win a return of disputed funds. Only when the consumer is provided a substitute check, the new Check 21 Act provides a 10 business day right of re-credit, but the Federal Reserve Board's narrow interpretation of the availability of this right in their regulations will restrict this right to those consumers who were provided with a physical substitute check, and not even require that banks provide that document on request. If, instead of image processing (no federal rights) or Check 21 processing (limited federal rights), the check is processed through lockbox conversion or point of sale conversion, it is covered by the EFTA (full federal rights).

When something goes wrong with a check payment, the consumer shouldn't have to sort out how that check was processed after it left the consumer's hands in order to learn his or her rights. Congress can take a significant step toward solving this mess by amending the EFTA to include all checks which are processed in whole or in part by the transmission of electronic information.

F. Update Jurisdiction Limits and Statutory Penalties of the Truth in Lending Act and the Consumer Leasing Act

TILA's jurisdictional limit for non-dwelling secured consumer credit transactions was set at $25,000 in 1968. That amount in today's dollars would be over $132,000.[41] The equivalent for the statutory damages amount of $1,000 in 1968 would be over $5,000 today. The numbers in the current statute need to be updated, and an inflation factor built in. The Consumer Leasing Act requires similar treatment.

Thank you for the opportunity to offer our comments.

[41] *See* Consumer Price Index, Inflation Calculator, U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/bls/inflation.htm.

Statement

Of

H. Randy Lively, Jr.

President & CEO, American Financial Services Association

Before the

House Financial Services Subcommittee

On "Financial Services Issues: A Consumer's Perspective"

September 15, 2004

DRAFT #5 9/13/04 4:00 p.m.

Mr. Chairman, Representative Sanders and Members of the Subcommittee:

I'm Randy Lively, President and Chief Executive Officer of the American Financial Services Association (AFSA). AFSA is a national trade association whose 300 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders and other financial services firms that ~~lend to consumers and small businesses~~.

I thank you, Mr. Chairman, for conducting this hearing, given the importance of consumers' credit in driving our economy. As of July 2004, outstanding consumer credit was over two trillion dollars according to seasonally adjusted figures from the Federal Reserve. Census Bureau figures for the second quarter of 2004 show a homeownership rate of 69.2%, meaning there are more homeowners in America than any time in history. Credit availability also enables people to buy vehicles that transport them to work, pay for education and training that qualifies them for jobs and start or expand small businesses. AFSA members are proud of their role in helping create advancement opportunities for many Americans and sustaining growth for our nation's economy.

As you know, we supported the Committee's successful effort that led to last year's enactment of the Fair and Accurate Credit Transactions Act (FACT Act). We thank you for your leadership, Mr. Chairman, in crafting balanced legislation that preserves our nation's consumer credit system. The FACT Act assures uniformity in our national credit granting system and maintains creditors' ability to offer a variety of products and services to meet borrowers' financial needs. It also entitles consumers to one free credit report each year and provides consumers with greater protection from identity theft through ~~several other means, including new~~ guidelines for fraud alerts.

In recent weeks, the subject of consumer credit has emerged on another front with the announcement of the Kerry-Edwards plan to protect Americans from abusive financial deals. A fact sheet on this plan says that Senators Kerry and Edwards "are committed to ensuring that responsible consumers continue to gain access to credit" and that companies "must be responsible and must play fair." AFSA agrees with both of these objectives -- but when it comes to the plan's recommendations on how to reduce lending abuse, we have an entirely different point of view. In the short time I have today, I'd like to touch upon two things that we're doing in this area.

The first is our members' Code of Ethics which includes voluntary standards in a number of areas, such as mortgage lending, arbitration agreements and the collection of past due accounts. AFSA and its members believe the interest of the public can be well served by conducting business in a way which builds and fosters public trust and confidence in the industry. Each AFSA member is expected to review our Code and establish and enforce their own policies to carry out the letter and the spirit of these standards.

~~Nearly five years ago, we adopted a voluntary~~ standard on credit bureau reporting. Basically, the standard says that AFSA's members agree to not withhold borrower information from credit bureaus in an effort to keep competitors from "poaching" good customers. The standard's ultimate intent is to ensure that borrowers receive the full benefits of their responsible use of credit.

The second thing to mention is our long-time involvement in consumer education initiatives for both adults and youth. The AFSA Education Foundation is a founding partner of the Jump$tart Coalition for Personal Financial Literacy, whose nearly 140+ partners include government agencies, associations, educational institutions and consumer organizations all working together to improve financial understanding in grades K-12 and on into college. As the chairman of the Jump$tart Coalition, I am very proud of its accomplishments and its success in drawing attention to the need for youth financial education in this country.

Our other major education initiative is MoneySKILL, a free, online personal finance curriculum from the AFSA Education Foundation that's aimed at the millions of high school students who graduate each year without understanding credit use, budgeting, retirement or other money management basics. To date, teachers in 45 states as well as in Canada, Guam, China, Germany, Malaysia and South Africa have registered to use the program. We continue to explore opportunities to reach more students with MoneySKILL, including possible partnerships that will allow the curriculum to become ~~available to higher risk youth.~~

MoneySKILL consists of 34 modules that students complete in about 40 minutes each. Within the course's general content areas – which include income, expenses, assets, liabilities and risk management – students receive unbiased information a number of fundamentals. These include the effect of income taxes on take-home pay, understanding interest when borrowing, using credit cards responsibly, how buying a car compares with leasing one, understanding different types of insurance and the costs and benefits of borrowing, to name a few.

Mr. Chairman, we certainly appreciate – and welcome -- Senators Kerry and Edwards' interest in reducing abusive lending, a practice that has long been condemned by the association and its members. And we agree that the industry should take a leadership role i addressing the problems, which is in part why we're involved in programs like MoneySKIL and coalitions like Jump$tart.

At the same time, we're concerned about the impact of the Kerry-Edwards plan on the functioning of the consumer credit market. When limits are placed on a creditor's ability to use performance-based pricing, responsible consumers who pay their bills on time inevitably bear the burden of higher costs generated by those who fail to properly manage their use of debt.

As noted by Federal Reserve Board Chairman Alan Greenspan, "Credit-scoring technologies have served as the foundation for the development of our national markets for consumer and mortgage credit, allowing lenders to build highly diversified loan portfolios that substantially mitigate credit risk." Over the past 80 years, the U.S. financial services system has evolved into the most efficient in the world, and one that serves more of its population than any other. Proposals to tinker with the underpinning of this system should not be taken lightly.

The good news is that we already have laws in existence to get at the unscrupulous lenders who are defrauding people – and we ought to do everything possible to enforce those laws to their fullest extent. Ultimately, however, the most effective way to deal with both excessive use of consumer debt and abusive lending is through education. Correct choices by the consumer represent the behavioral solutions to many of the problems the Kerry-Edwards plan seeks to remedy. We believe equipping people with the knowledge to make credit decisions that benefit them -- and avoid those that don't -- will greatly improve their financial situations while making our economy even stronger.

I appreciate the opportunity to be here today and would be happy to answer any questions you may have.

WRITTEN STATEMENT OF
MICHAEL F. McENENEY
ON BEHALF OF
THE CONSUMER BANKERS ASSOCIATION

Before the Subcommittee on Financial Institutions and Consumer Credit
September 15, 2004

Good morning Chairman Bachus, Ranking Member Sanders, and Members of the Subcommittee. My name is Michael F. McEneney. I am a partner in the law firm of Sidley Austin Brown & Wood LLP. It is my pleasure to appear before you this morning on behalf of the Consumer Bankers Association ("CBA"). The CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits, and delivery. CBA was founded in 1919 and provides leadership, education, research, and federal representation on retail banking issues such as privacy, fair lending, consumer protection legislation, and regulation. CBA members include most of the nation's largest bank holding companies, as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

Today's hearing is focused on financial products and services from the consumer's perspective. There is no doubt that today's financial marketplace looks quite good from the consumer's perspective. The financial services marketplace offers consumers a wider variety of financial products and services than ever before. This includes loans, deposit products, checking accounts, investment options and a growing variety of payment and remittance services. Not only can consumers choose from a wide range of products, but they can obtain them over the phone, using the Internet, or through personal interaction at the financial institutions' offices.

Our financial marketplace is truly a success story. However, the success did not develop overnight, or by accident. There was a time when consumers did not enjoy all of the conveniences they are offered today. In fact, it was not too long ago when retail banking services looked much different than they do today. Back then many people had to carry cash or checks at all times because credit cards as we know them did not exist. And to get that cash people had to spend time going to the bank branch and standing in line for a teller. Why? There was no such thing as an ATM. Visiting the bank branch in person was also necessary to get a loan, and, in many instances, you had to have an account with the bank. The opportunities to shop around for a loan that are available today really did not exist. Most people were just happy if their bank approved them and accepted the rate the bank was offering at the time. The approval process could last weeks, and fewer people qualified for loans than would qualify today.

There are obviously a number of reasons for the spectacular evolution of the financial services industry and the ever-expanding choices available to consumers. However, I believe that most of these reasons relate to providing financial institutions with the flexibility to compete

fiercely with one another to provide a better product to consumers at lower costs. I would like to use a few examples to illustrate my point.

First, the process by which consumers obtain home mortgages has been simplified and made more efficient through increased competition in the marketplace. Hopeful homebuyers at one time submitted their mortgage application to their bank and waited on pins and needles for several days, or even a few weeks, while their application was considered. Those who did not have a relationship with a bank, or those who did not have many local banks from which to choose, obviously had a more challenging time obtaining a mortgage. However, today, consumers benefit from lenders across the country competing with one another to provide consumers with home loan opportunities wherever they may reside. Decisions are oftentimes made almost instantaneously, and lenders are able to offer loans that meet a variety of consumer needs. Given the number of lenders and types of mortgages available, creditworthy borrowers are likely to have several choices when choosing how to finance their homeownership.

Second, we take for granted that a consumer today can obtain a credit card that suits his or her individual needs. The credit card may offer frequent flyer miles, or the logo of the consumer's charity. It may offer the consumer a rebate on some or all purchases the consumer makes with the credit card. The consumer can also shop for low interest rates, and credit cards that do not have any annual fees. I believe that all of these benefits can be traced in great part to the ease with which credit card issuers can compete with one another through a variety of mechanisms, including a process known as "prescreening."

It is hard to imagine, but there once was a time when annual fees were common and consumers obtained few "fringe" benefits for using their credit cards. Today, most people can find an offer for a card without an annual fee or that offers other benefits simply by reading their mail. Before large numbers of card issuers engaged in prescreening, a consumer obtained a credit card from his or her local bank. Although local banks competed with one another to provide retail banking services to consumers, including credit card products, the competition was nothing like we see today. Some time ago, credit card issuers began to prescreen consumers in order to offer them credit cards. This process, combined with uniform rules for interest rates and fees, allowed banks in any location to offer credit cards to consumers *nationwide* through the mail. Basically, prescreening allows a creditor to obtain a limited amount of credit information in order to offer consumers a "firm offer of credit." With the advent of prescreening, suddenly the consumer did not need to be satisfied with the credit card from his or her local bank—a card that likely had an annual fee and comparatively higher interest rates. In fact, as more card issuers made more credit card offers to consumers, consumers could pick from a variety of credit cards. Naturally, this competition fostered lower prices and improved features on credit cards. Perhaps these developments help explain why the staff of the Federal Reserve Board recently found that 91% of cardholders are satisfied with their credit card issuers.

Third, the ability of financial institutions to price their products in a more precise manner has resulted in enormous benefits to all consumers—most notably the extraordinary homeownership rate. This Subcommittee has gathered large amounts of information pertaining to our national credit system as part of its deliberations on the FACT Act just last year. However, a few of the key points are worth repeating today. The consumer reporting process has developed into a very sophisticated information delivery mechanism that allows lenders to

evaluate large amounts of objective and accurate information about consumers. Successful lenders have used this information to evaluate and manage risk in a way that allows them to lower the costs of credit to those consumers who have good credit histories. Yet, consumers with good credit histories are not the only primary beneficiaries of the benefits resulting from the developments fostered by our national credit system. In fact, as lenders obtain more information about potential borrowers through applications and credit reports, for example, they can offer credit to consumers who at one time could not qualify for credit. Now, instead of a bank offering a "one size fits all" loan product to only those consumers with above average credit histories, the bank can use risk-based pricing to offer more consumers access to credit at a variety of risk-based prices. Indeed, many reputable lenders have developed successful lines of business making prudent loans to lower- and moderate-income families that have been traditionally underserved. The more competition there is from reputable lenders making responsible lending decisions to consumers, the less opportunity there will be for bad actors to prey on the vulnerable. That means more home mortgages, more college education loans, and more auto loans for safe transportation for consumers of all walks of life—not just the wealthy or those with perfect credit histories.

Competition in the market place also means an expanding pie where those who have been traditionally underserved can enter the mainstream of our economy. For example, CBA's members continue to develop and expand product offerings to satisfy the demands of an increasingly diverse market. This includes efforts to bank the so-called "unbanked" through use of payroll cards, stored value products, and remittance services in addition to offering low-cost traditional banking products, such as checking accounts. For example, CBA is hosting a Hispanic Banking Forum later this month to highlight bank activities in this area and provide an opportunity for banks to share their knowledge and experience.

Mr. Chairman, current law ensures that consumers receive valuable information with respect to financial products. Laws such as the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, and the Real Estate Settlement Procedures Act establish frameworks under which consumers are provided important disclosures with respect to the price of financial services, and the terms on which they are offered. Consumers receive a variety of disclosures in other contexts, such as under the Equal Credit Opportunity Act and the Fair Credit Reporting Act. In short, it is clear that consumers do not lack for disclosures of information in connection with financial transactions.

It is also important to note that our financial marketplace is a complex system that relies on providing consumers with choice. Any system that offers choices requires consumers to understand the relative benefits and costs of those choices. Disclosure laws like Truth in Lending are important, but they can only do so much in the absence of fundamental financial literacy on the part of consumers. Banks have long understood that the most innovative and beneficial financial products in the world are likely of no use to the consumer who lacks basic knowledge of how to participate in our financial system, and unsophisticated consumers are more easily targeted by the unscrupulous. That is why banks have been in the forefront of efforts to expand financial education.

In April 2004, CBA published a survey regarding the progress made in the financial literacy of consumers as a result of banks' educational efforts. The report focuses on eight areas

including credit counseling, mortgage and homeownership, predatory lending, public school programs, college programs and small business training. The results of the survey evidence an increase in banks that participate in consumer financial literacy education. Of those that responded, 100% of the institutions participate in at least one of the eight areas of concentration. Most notably, approximately 89% of the 54 responding institutions offer public school financial literacy programs (this is a 16% increase from the survey conducted one year ago), and financial literacy efforts of banks in colleges almost doubled. A portion of CBA's 2004 Survey of Bank Sponsored Financial Literacy Programs has been submitted with this testimony. The entire survey may be found at www.cbanet.org.

In conclusion Mr. Chairman, I would like to highlight that consumers of all income levels in the United States have financial opportunities that are the envy of the world. Virtually any creditworthy consumer can obtain credit when they need it. Retail banking and other financial services are widely available and can be obtained by walking down the street to the local financial institution, or by using phone, mail or the Internet. Continued improvements in technology and risk control allow more financial institutions to improve their financial products, to offer them to broader groups of consumers, and to develop new financial products altogether. Naturally, we face the challenge of ensuring that consumers understand the opportunities they have available to them. But I can assure you that CBA's members are committed to ensuring that consumers receive the information they need, including through information disclosures and financial education materials and opportunities.

Thank you again for inviting me to appear before you today. I would be pleased to answer any questions.

Composition of Gross Job Growth

Payroll Jobs In Thousands	Clinton First Term		Clinton Both Terms		Clinton Last Three Years		Clinton Jan-July 96		Bush Jan-July 2004	
	Total	% of Overall	Total	% of Overall	Total	% of Overall	Total	% of Overall	Total	% of Overall
Above National Average Hourly Pay										
Information	342	3.2%	1,053	5.1%	562	7.6%	60	3.7%	15	1.2%
Construction	1,011	9.5%	2,133	10.3%	858	11.6%	214	13.4%	141	10.7%
Natural Resources and Mining	0	0.0%	0	0.0%	0	0.0%	7	0.4%	24	1.8%
Financial Activities	441	4.1%	1,131	5.5%	435	5.9%	114	7.1%	32	2.4%
Professional And Business Services	2,423	22.7%	5,258	25.4%	1,938	26.2%	368	23.1%	343	26.1%
Professional and Technical Services	*678*	*6.4%*	*1,924*	*9.3%*	*939*	*12.7%*	*110*	*6.9%*	*82*	*6.2%*
Administrative and Waste Services	*1,664*	*15.6%*	*3,158*	*15.3%*	*937*	*12.7%*	*246*	*15.4%*	*241*	*18.3%*
Temporary Help Services	*632*	*5.9%*	*1,300*	*6.3%*	*431*	*5.8%*	*87*	*5.4%*	*91*	*6.9%*
Manufacturing	495	4.6%	385	1.9%	-412	-5.6%	-8	-0.5%	81	6.2%
Education and Health Services	1,775	16.6%	3,225	15.6%	1,051	14.2%	224	14.0%	180	13.7%
Subtotal	**6,488**	**60.7%**	**13,184**	**63.7%**	**4,845**	**65.5%**	**986**	**61.7%**	**817**	**62.1%**
Below National Average Hourly Pay										
Trade, Transportation, and Utilities	2,442	22.9%	4,252	20.5%	1,372	18.6%	338	21.1%	293	22.3%
Transportation and Warehousing Subtotal	*464*	*4.3%*	*980*	*4.7%*	*388*	*5.2%*	*82*	*5.1%*	*75*	*5.7%*
Other Services	430	4.0%	880	4.3%	296	4.0%	73	4.6%	38	2.9%
Leisure and Hospitality	1,320	12.4%	2,388	11.5%	883	11.9%	201	12.5%	167	12.7%
Subtotal	**4,192**	**39.3%**	**7,521**	**36.3%**	**2,550**	**34.5%**	**612**	**38.3%**	**498**	**37.9%**
Total	**10,680**	**100.0%**	**20,705**	**100.0%**	**7,395**	**100.0%**	**1,598**	**100.0%**	**1,315**	**100.0%**
Government	923	8.6%	2,247	10.9%	1,079	14.6%	120	7.5%	24	1.8%

	Clinton First Term	Clinton Both Terms	Clinton Last Three Years	Clinton Jan-July 96	Bush Jan-July 2004
Percent of Jobs Created Above National Average Pay	**60.7%**	**63.7%**	**65.5%**	**61.7%**	**62.1%**
Percent of Jobs Created Below National Average Pay	**39.3%**	**36.3%**	**34.5%**	**38.3%**	**37.9%**

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TESTIMONY OF

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THE FOOD MARKETING INSTITUTE

THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTUTIONS
AND CONSUMER CREDIT

"FINANCIAL SERVICES ISSUES: A CONSUMER'S PERSPECTIVE"

WEDNESDAY, SEPTEMBER 15, 2004

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to provide written testimony on the important issues surrounding consumers and financial services. The Food Marketing Institute's (FMI)[1] member grocery wholesalers and retailers consider themselves to be the purchasing agent of the consumer, a responsibility we take very seriously. Our members are always looking for ways to provide our customers with the best product, the best value, and the best customer service

Some of our customers like the flexibility of being able to pay with credit or debit cards in addition to cash and check. In this incredibly competitive business, no one wants to lose a customer. So supermarkets increasingly have begun to accept these new forms of payment. As the number of supermarkets accepting credit and debit cards has grown, the rates merchants and therefore customers are charged for these transactions has also grown – dramatically! Indeed, the Tower Group reported in 2003 that grocery/supermarkets account for more than half of all PIN-based debit transactions and 59% of all signature-based debit transactions. At the same time, the cost of accepting these cards has been skyrocketing, often exceeding the 1% average net profit margin of a typical grocery store. Consider these facts and their impact on consumer prices in a business with a 1% profit margin.

- The cost of electronic payments is one of the fastest growing and least controllable costs of doing business.
- There have been 11 credit/debit rate increases in the last 12 months with still more expected this year.
- PIN debit fees are up 267% since 1999.
- Electronic payments volume has increased over 500% from 1989 to 2000, and continues to grow dramatically. In all other parts of our business as volume increases over an existing network, costs per item decrease.
- Card association (VISA/MasterCard) operating rules and regulations prohibit merchants from passing costs directly to consumers or giving them notification of fees paid by merchants on the transaction. Consumers have no knowledge of these hidden fees and thus cannot modify behavior.
- Card associations collected $29.2 billion in 2003 on interchange, which is paid directly to the issuing bank.

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[1] FMI conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of $340 billion — three-quarters of all food retail store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 60 countries.

- Increases are just as significant, if not more significant, for debit than credit because of the proportion of the growth in debit transactions and lack of risk/cost to the financial institutions of a debit transaction as available funds are simply being transferred between two accounts.
- Airline miles/rewards drove credit usage; financial institutions are expanding miles/rewards to signature debit as the rates for debit increase with the goal of increasing signature debit usage.
- Debit and credit fees are now calculated using a similar pricing model, although they are very different products – both now include a percentage charge plus a flat fee.
- The current interchange fee model is inverted from normal competitive market models – more volume means more cost; volume cannot be used to lower costs; merchant fees are invisible to consumers.

This is by no means a problem confined to this country. Central banks, legislative bodies and regulatory agencies around the world have been examining the impact of these fees on consumers and consumer prices and exploring methods of regulating these growing fees. Several countries including the United Kingdom, Australia, Israel and the European Union have initiated actions such as caps on fees, changes in operating rules, antitrust/fair trade investigations, regulation of the allowed components of fees, studies and legislation. With fees that are higher than any of these international competitors, U.S. merchants and U.S. consumers are at a competitive disadvantage unless similar actions are considered in this country.

FMI commends this committee for looking at the consumer's perspective in financial services issues. We also commend the Congress and the Federal Reserve for initiating a study of debit card transactions and fees. We ask this Committee to continue its legislative review and analysis of this very concerning issue.

Thank you.

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