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Testimony of

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Hearing On

"Consumer Protection and Middle Class Wealth Building

in an Age of Growing Household Debt"

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Good afternoon, and a special thank you to the Subcommittee on Consumer Protection and Financial Institutions – especially Chairman Brown and Ranking Member Corker – for convening a hearing focused explicitly on exploring ways to help everyday Americans build (or rebuild) their wealth at a time when our collective and individual balance sheets are very much in the red. For over thirty years my organization has been deeply engaged in researching and advancing promising strategies that help low, moderate and middle income (LMI) families and communities build wealth and financial resiliency. At no time has our work and the work of our many partners been more needed – or more difficult – than right now. And at no time has the leadership of Congress on issues of consumer financial protection and helping families save and build assets been more important than right now.

It is my goal with this testimony to achieve three objectives:

- First, I will provide you with a concise (but bleak) picture of the current state of financial security among middle and low income households in America, and describe how the set of policies we currently have on the books to protect LMI consumers and help them build wealth have missed their mark.

- Second, I will present a framework that illustrates – from a household's perspective – what it really takes to build financial security and economic mobility over time.

- Third, I will describe a range of actions that members of Congress – and of this subcommittee in particular – could take in the near future that would help millions of Americans successfully navigate the financial marketplace and begin to save, invest and build assets that will help us to rebuild our middle class and our economy.

<u>Financial Security and Stability Among LMI Households</u>

The middle class squeeze in America is more pronounced and more consequential than at any time in modern history. New research in the last few years has really helped us get a better handle on some additional the dimensions of financial security that go beyond income poverty and unemployment statistics. For example:

- Over half of the population in the U.S. with a credit score has what can be considered subprime credit**.** In some areas, that number closes in on 70 percent.
- One in four Americans either have no bank account, or are considered "underbanked" meaning they use alternative and largely unregulated financial products and services that are often very high cost and abusive. In the African American community, the number of un- and underbanked households rises to one in two, or 50 percent.
- Over half the population doesn't have enough liquid savings & assets to help them survive at the poverty level for 3 months if they lost their source of income (that's only about $4,000 for a family of 3).
- Another recent survey found that over half the population isn't confident they could find a way to scrape together $2000K if they had an emergency.
- Last week the company CardHub.com published its Q2 2011 Credit Card Debt Study, showing that consumers accumulated $18.4 billion in new debt in the second quarter of 2011 – a 66% increase over the same quarter in 2010, and a 368% increase over the same period in 2009.
- Middle income household debt-to-income ratios have risen from 67 percent in 1983 to 100 percent in 2001 and 157 percent in 2007. And the evidence indicates that the debt pile-on was directed at maintaining normal consumption not enhanced consumption.

None of this bodes well for the future of America's middle class. Make no mistake, "middle income" and "middle class," are not synonymous. To illustrate this point, consider the 2009 research study from the Pew Economic Mobility Project that found that almost half (45%) of black children *whose parents were solidly middle income* ended up falling into the bottom of the income distribution as adults, compared to only 16% of whites.

Clearly there is something besides income that has historically helped to make middle class status more "sticky" and multi-generational. One of the key "somethings" has been asset development -- homeownership, higher education, savings, inheritance – these are all part of the explanation. Historically white families have more of these. A lot more. Professor Thomas Shapiro of Brandeis University and renowned expert on racial wealth disparities finds that white families are four times more likely than blacks to inherit, and when they do the median inheritance is 10 times greater. Another recent Pew report found that between 2005 and 2009 median household wealth plunged 66 percent among Hispanics and 53 percent for blacks, while dropping just 16 percent for white households. The result is that the net worth of white families is now 20 times greater than that of black families and 18 times more than Hispanic households - the largest gap in 25 years. The middle class is shrinking across the board. But for communities of color, the middle is being decimated.

<u>The Role of Tax Policy in Asset Building</u>

The shrinking ranks of the middle class and the growing wealth gap are phenomena that are as predictable as they were preventable. The recession has clearly exacerbated the problem, but at its core the widening wealth gap reflects years of government policy decisions that disproportionately help high-income households build assets while virtually ignoring the needs of the middle class and explicitly penalizing efforts by low-income households to save and invest.

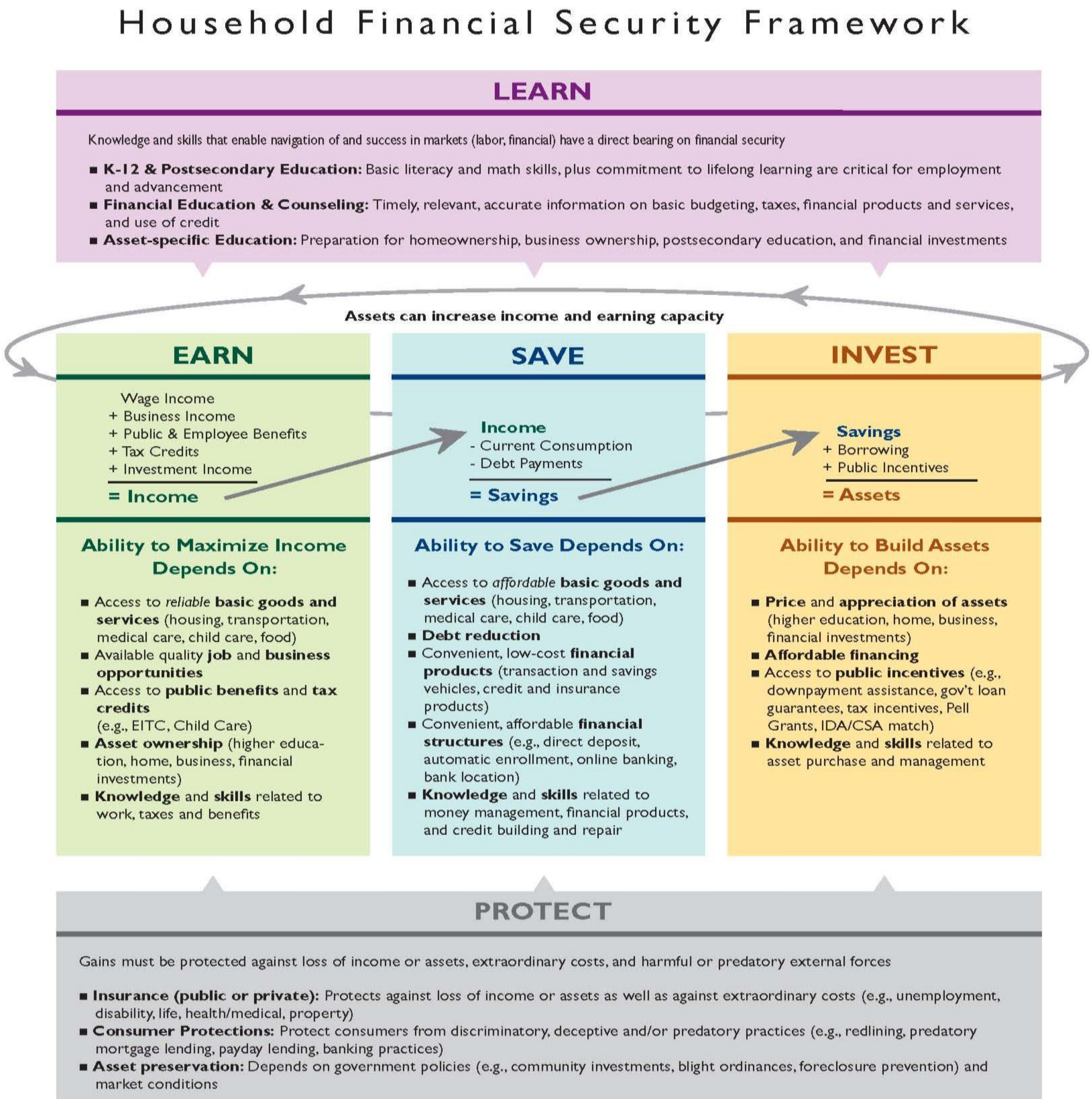
Last year CFED and the Annie E. Casey Foundation published the report *Upside Down*, which showed that the federal government spends upwards of $400 billion a year to encourage Americans to save for retirement, go to college, start businesses and purchase homes. But here's the catch: These "asset-building" policies are primarily administered through the tax code as special deductions and deferrals. As a result these subsidies are overwhelmingly accessible primarily to Americans in the very highest income brackets, with little evidence that the incentives generate much in the way of net new savings. Meanwhile, the majority of the population in middle and lower income brackets who do not have enough of a tax liability to warrant itemizing -- those most in need of building a financial cushion to deal with short term income shocks and long term economic uncertainty -- receive miniscule levels support.

In 2009 more than half of the $400 billion in asset-building benefits went to the top 5 percent of tax-payers. The bottom 60 percent of households received less than 4 percent of those subsidies. Another cut of the data shows that households making a million dollars or more received a $95,000 subsidy to help them build assets – enough to finance a pretty good college education for their kids. Households making less than $20,000 got about five dollars – enough to finance two days of school lunch.

This ineffective and skewed allocation of expensive tax subsidies has added to both the federal deficit and the growing wealth gap between Americans with means and those working to make ends meet.

<u>A Framework for Household Financial Security</u>

The thing is we do know what it really takes for a household in America to build financial security over time. But at present we don't do a lot to help average families succeed in this endeavor. CFED has created the Household Financial Security Framework to describe the basic elements of building household financial security, which, on the face of it, looks relatively straightforward. Individuals must first <u>***learn***</u> the knowledge and skills that enable them to <u>***earn***</u> an income and manage their financial lives. They then use their income to take care of basic living expenses and service debt payments, and then – if income has exceeded expenses – they can <u>***save***</u> some for future purposes. When they have accumulated enough liquid savings, they can leverage those savings and <u>***invest***</u> in assets that will appreciate over time and generate increasing levels of income, equity and net worth. Throughout the cycle, access to safe, affordable financial products, insurance and consumer protections help households <u>***protect***</u> the gains they make.



In reality, there is nothing particularly straightforward about getting a household balance sheet to balance, much less tip toward asset accumulation. As the data I reviewed earlier makes abundantly clear, financial security is the exception rather than the rule for the majority of Americans. Every day, as people try to navigate the increasingly complex financial marketplace, they need to make choices without full information, clear guidance or adequate protection. It's not that people don't understand the downsides, inconveniences and long-term implications of being unbanked, using costly credit, skipping their mortgage payment or failing to save for college or retirement. But without adequate income, savings or products options, their choices are limited. A big part of the problem has very little to do with individual knowledge and skills and instead has to do with the systems, structures and protections that exist – or don't – in the financial marketplace.

The primary goal of policy change aimed at strengthening the financial security of households should be to ensure that the market provides a range of safe, affordable and accessible financial products that meet the transactional, savings and credit needs of low and moderate income households and to establish consumer protections that enable all households to participate fully in the consumer financial markets with confidence and trust.

Which brings me to my final objective: Outlining a range of specific policies and actions I would urge members of the subcommittee to take with your colleagues to improve the asset building opportunities of all Americans.

Federal Policies to Encourage Asset Building and Consumer Protection

Some would argue that in the current economic climate, with so many people struggling just to make ends meet, it isn't realistic to focus on saving and wealth building. But this view is unnecessarily limited; earning and saving is not an either/or scenario, and it is incumbent on us to help households find a way to do both. Saving is critical for low, moderate and middle income households precisely because these families are the most vulnerable to income shocks from job loss, medical emergencies and even car repairs. Such emergencies can knock them totally off course financially. Research from the Urban Institute shows that owning a small amount of assets—even just the $4000 or so that it takes to move out of asset poverty—provides as much protection against material hardship in the face of an economic shock as being in the next highest tier of the income distribution. As a starting point, we must at the very least commit to getting people on the path toward financial stability by giving them the tools and assistance required to reduce debt, repair credit, get banked and build savings, and by protecting them from scams and from abusive and deceptive products. Households need access to safe, affordable consumer financial products and services. Individuals and families need to have information in order to effectively compare the costs and benefits of different financial products and make the best choices for themselves.

CFPB Recommendations

A significant portion of this work now falls under the purview of the Consumer Financial Protection Bureau. This institution can provide vital support to consumers in the financial markets, and do so without massive new government spending or onerous mandates. Rather, CFPB can do a great deal to facilitate savings and asset building by LMI households through ensuring that consumers' interests are considered and valued in the context of federal financial regulation processes that already exist. Congress, of course, has a critical role to fulfill with regard to CFPB; you can ensure that the Bureau is fully capable of meeting its mission and establish accountability for achieving its goals.

- *The first step that the Senate should take is to confirm a director to lead CFPB*. One of the overarching goals of the Dodd-Frank Act was to unify the oversight and regulation of the entire financial services marketplace under one set of clear, transparent rules with consumer well-being in mind. Without a director, the Consumer Financial Protection Bureau doesn't have the authority to regulate many types of nonbank financial businesses, leading to an uneven playing field in which some firms are required to play by the rules while others are not. The Bureau is significantly restricted in its ability to regulate in many areas, including nonbank financial institutions, payday lenders, private education lenders, consumer credit rating agencies, and mortgage servicers.

  CFPB must have a confirmed director not just for administrative reasons or to expand its authority, but also to actually achieve its primary objective: to protect consumers from financial products that exacerbate financial distress. Rather than banning "bad" products, the Bureau's leadership has indicated that it plans to pursue this mission through incenting the delivery of products and services that provide measurable benefits to consumers and by ensuring the consumers have the information they need to make informed choices about what products and services are best for them. The alternative credit industry thrives for three reasons all too familiar to consumer protection experts: first, the intense demand for emergency credit; second, a captive, vulnerable, and often unsophisticated population; and third, the lack of a single, clear, trustworthy, and enforceable regulations for the product landscape. CFED commends the Bureau for its intention to focus on improving consumers' ability to access and understand information about these credit products through disclosures, financial education and supervision of lenders.

- *Congress should encourage the CFPB to focus on improving disclosures for all consumer financial products*. Both transaction products and credit products can and often do build hidden fees and penalties into their products that create conditions of financial uncertainty for LMI consumers that they can ill-afford. With transaction products, issues include overdraft charges, insufficient funds fees or point of sale charges. For example, research by former Assistant Secretary of the Treasury Michael Barr shows that the most important features of transaction products for LMI consumers are transparent monthly costs and federal consumer protection.

- *The CFPB should examine the impact that expanding the amount of information reported to consumer credit rating agencies would have in helping thin- and no file consumers build their credit records*. The CFPB should study and supervise the credit information markets with an eye toward increasing their transparency and fairness.

Consumer credit reports are now sought not just by prospective lenders evaluating specific consumers' loan applications, but also by landlords, employers, banks and others. Credit reports have never been more critical to a person's ability to participate in the financial mainstream, but they are opaque, lightly regulated, and difficult for consumers to work with. Moreover, as many as 70 million Americans have no credit files or no payment histories in their credit files, and consequently have no credit score. Tens of millions more have too few payment histories in their credit files to be scored with precision. A straightforward solution is to simply add more information to credit files. Utility and telecommunications bills are nearly universal; including all payment information for these transactions would enhance credit access for millions of households. This market-driven policy response will help lenders better assess credit applicants and decrease the nation's persistent—and widening—wealth gap.

Congress, however, has an important role here, that the Bureau alone cannot accomplish. Despite compelling evidence that alternative data credit reporting is a win-win scenario for borrowers and lenders, utility and telecom firms are reluctant to report full payment histories to the credit bureaus due to regulatory uncertainty; currently most firms only report late payments. Some states have introduced legislation to promote alternative data credit reporting while others have moved to prohibit the practice. At the federal level, some companies that previously reported full payment histories to the credit bureaus have stopped due to uncertainty about privacy requirements. Congress can resolve the uncertainty through legislation that provides affirmative permission to utilities and telecom firms to report all payment history to the consumer credit bureaus.

Beyond the CFPB

Looking beyond the CFPB, Congress can support many equally important policy reforms and new opportunities to enhance the ability of LMI families to save money and build assets. Our research shows that current U.S. policies – or at least the 90% that operate as tax expenditures – are regressive, invisible and unregulated. They are of little help to the majority of households that are trying and become more financially secure. Significant improvements could be made with the following proposals:

Remove disincentives to save.

One way to do this would be to eliminate asset tests as this would primarily benefit working poor households. Asset limits, or caps on the maximum value of assets a household may have to be eligible for certain benefits programs, deter people from seeking work, opening bank accounts and saving money. CFED supports reforms that encourage economic self-reliance. Congress should consider removing the penalties in our safety net programs for developing savings that can eventually help families become financially independent. Congress could follow the lead of Ohio, Virginia, Alabama, Louisiana and Maryland – all states that have eliminated asset tests in their TANF program. They realized that families applying for TANF had no real financial assets. The cost of staff time to find non-existent assets was exorbitant – Virginia reported that it was spending about $330,000 a year to weed out just one half of one percent of participants. We commend Congress for making progress: Senator Chambliss led efforts to exempt IRAs, 529 and Coverdells from asset limit tests in SNAP. But further action is needed.

Congress should raise asset limits in SSI. The current rates, set at $2,000 in the 1980s and never raised for inflation, dampen initiative and discouraged people from banking and saving, working toward some amount of financial self reliance. The Senate could follow the lead of the bipartisan SSI Saver's Act (H.R. 2103).

Improve the existing system for savings.

- *Expand the Saver's Credit*. The Saver's Credit should be strengthened and reformed to enable millions of Americans to receive an additional incentive to build their savings and enhance their financial security. The original Saver's Credit passed in 2001. The IRS recently released data showing that 6.4 million tax filers claimed the credit in 2009, the largest number of claimants ever. The average credit was only $167 though, largely because tax filers with income low enough to claim the credit have limited tax liabilities. This speaks to the need to improve the credit, so it can serve the purpose it was designed for: make saving for retirement rewarding and straightforward for low- and moderate-income workers. CFED proposes expanding the Saver's Credit to provide a 50% match on retirement savings up to $500 ($1000 for joint filers), making the credit refundable, and depositing the match directly into the filer's retirement savings account. With these changes, the Saver's Credit would reach as many as 50 million tax filers. This would provide powerful incentive to lower-income people who desperately need to build wealth and provide an easy, safe way for them to save and invest.

- *Enact Automatic IRA*. Seventy-eight million people, half of the U.S. workforce, lack access to employer-sponsored retirement plans. Automatic IRA is a legislation that will enable workers without a retirement plan at work to use payroll deductions to open and fund IRAs with a minimum of effort. Increasing personal retirement savings is a critical challenge that policymakers should address. Social Security has been the most effective solution to elderly poverty, but it will be increasingly important for workers to supplement Social Security with personal savings. Automatic IRA is an inexpensive, market-friendly way to ensure that 78 million workers have the opportunity to save.

- *Reauthorize the Assets for Independence Act*. The Senate should reauthorize and improve the Assets for Independence Act (AFIA, P.L. 105-285). Individual Development Accounts (IDAs) are a proven tool to help low-income families achieve financial security through savings and asset building, and AFIA is the primary source of Federal support for IDAs. The Assets for Independence program is one of the few programs that reaches low-income households that focuses on wealth-building and financial education to help these households get ahead. As a result, AFIA has been critical to the success and widespread adoption of IDAs from few accounts in the 1990s to more than 120,000 accounts today.

  Unfortunately, current economic realities such as state budget crises and reduced availability of philanthropic grants pose challenges to a program that has successfully helped low-income families lift themselves out of poverty. Strong interest and limited local funds have resulted in nearly every IDA program in the country placing potential savers on waiting lists. The reauthorization of AFIA presents an important opportunity to make small, but critical modifications to increase AFIA's utilization and ensure its continued success. Recommendations include improving and streamlining requirements and opportunities for grantees, expanding participant eligibility qualifications and savings goals, and developing new partnerships, promoting research and encouraging innovation.

Build a new system of Child Savings Accounts

Children's savings accounts (CSAs), tax-preferred investment accounts opened for each child at birth, are powerful financial products that could expand economic and educational opportunities for children by encouraging long-term planning, building family wealth and promoting financial literacy. CFED supports the efforts of our colleagues at the New America Foundation to establish a lifetime savings account for every newborn child in America. The America Saving for Personal Investment, Retirement, and Education Act ("The ASPIRE Act") would set up a special account at birth for every child that could later be used to pursue post-secondary education, buy a first home, or build up a nest-egg for retirement. The ASPIRE Act calls for each child's LSA to be endowed with a one-time $500 contribution at birth. Children living in households with incomes below national median income will be eligible for both a supplemental contribution of up to $500 at birth as well as the opportunity to earn up to $500 per year in matching funds for amounts saved in the account. Financial education would be offered in conjunction with the accounts.[1]"

States and cities are starting to recognize the value and potential of offering children's savings accounts. In Maine, every child is eligible for $500 in a college savings 529 account, and twelve other states now match contributions to 529s. In San Francisco, every public Kindergarten student is given a savings account upon enrollment that is seeded with $50 ($100 if they receive free and reduced cost lunch), and provided with matching incentives and financial education over time. Singapore, Canada and even the United Kingdom have

[1] http://assets.newamerica.net/the_aspire_act

used state funds to open bank accounts for kids realizing that kids with college funds are more likely to achieve financially.

Taken together, all of these policy proposals would cost a small fraction of what the Federal government currently spends to subsidize asset building for taxpayers in the highest income brackets, and could easily be funded by capping some of those expensive unfair and ineffective subsidies currently in place. Most importantly, they would begin to address some of the long-term inequities that contribute to the wealth gap, and they would help millions of families build a more secure economic future.

Mr. Chairman, thank you very much for this opportunity to testify before the Subcommittee. I would be pleased to answer any questions you and the other members of the Subcommittee may have.