Testimony

to the

Senate Committee on

BANKING, HOUSING AND URBAN AFFAIRS

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regarding

**All Current Proposals for Legislation on Financial Services Reform**

Testimony presented by both:


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on behalf of their organizations and clients as well as:

**Consumer Federation of America**
**Consumers Union**
**National Association of Consumer Advocates**
**National Community Reinvestment Coalition**

Mr. Chairman, Senator Sarbanes, and Members of the Committee, this written testimony accompanies the verbal comments provided to you today by both Ed Mierzwinski of the **U.S. Public Interest Research Group,**[1] and Margot Saunders of the **National Consumer Law Center**[2] on behalf of our low income clients. We both thank you for the opportunity to provide comments on the many issues which may arise as you consider proposals for financial services reform. This testimony is also provided to you on behalf of the **Consumer Federation of America**[3], **Consumers Union**[4], the **National Association of Consumer Advocates**[5], **and the National Community Reinvestment Coalition.**[6]

There are many proposals for changes to the laws governing financial services currently under consideration in the Congress. We support some of these proposals, we have no positions on others, and we have grave concerns regarding a few. In this testimony, we will first address those proposals which pose the greatest threat to the low and moderate income consumers that we represent. Next we will describe our support for a number of important changes that are needed to update federal law to protect consumers. *Given the huge potential number of proposals that could be considered under the rubric of financial services reform, if we do not address a particular proposal, it should* not *be assumed that we support it. We have endeavored to identify those proposals which we believe you may consider and address those, but we may*

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[1]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.

[2]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.

[3]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.

[4]**Consumers Union** is the nonprofit publisher of Consumer Reports magazine, is an organization 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.

[5] **The National Association of Consumer Advocates** is a non-profit corporation whose members are private, and public sector attorneys, legal services, law professors and law students , whose primary focus involves the protection and representation of consumers.

[6]**National Community Reinvestment Coalition** is a national trade association representing more than 600 community based organizations and local public agencies who work daily to promote economic justice and increase fair and equal access to credit, capital and banking services to traditionally underserved populations in both urban and rural areas.

*have missed some.*

## I. Harmful Proposals to Consumers

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C. S. 884 is *NOT* a consumer protection bill--it is solely designed to protect the **rent to own** industry from meaningful consumer protections**.**

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E. Exemption of **mid-size banks from some CRA** requirements would be damaging to communities.

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## II. Important Proposals to Update Federal Laws to Protect Consumers

G. Make sure the **EGRPRA** process is fair to consumers.

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I. All banks, including state chartered banks, should be prohibited from providing exorbitantly priced **pay day loans** in violation of state laws.

J. The jurisdiction limits and statutory penalties of the **Truth in Lending Act** and the Consumer Leasing Act need to be brought up to the 21$^{st}$ Century standard.

K. **Credit unions** should be permitted to provide check cashing and remittance services to anyone in their field of membership.

L. Expand the **Electronic Fund Transfer Act** to apply to all forms of electronically processed payments

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# I. Harmful Proposals to Consumers

## A. Expansion of industrial loan companies is dangerous to the banking system and taxpayers.

H.R. 1375 takes the very dangerous step of allowing financial firms and some commercial entities to set up a new, nationwide commercial banking system through industrial loan companies (ILCs) that is subject to much less rigorous oversight than under the current structure. This has enormous negative implications for the safety and soundness of these banks and thus for taxpayers who, of course, support the deposit insurance system. Our organizations agree with the Federal Reserve Board that the establishment of such a parallel, poorly regulated banking scheme would be very harmful. ILCs were intended to be limited purpose institutions; yet now seek to emulate the powers of commercial banks without the oversight. Allowing them to offer business checking or branch nationwide would be a mistake.

The House bill would allow many existing and new ILCs to branch into all 50 states, whether these states approve or not, and to offer business checking services. (Presently, ILCs are chartered and operate in only five states, although 17 states would permit ILCs to branch.) Business checking can only be provided by very small ILCs with less than $100 million in deposits.) Huge financial firms like Merrill Lynch, American Express, and Morgan Stanley--all of which currently own ILCs--would soon be able to offer federally insured commercial banking services indistinguishable from those offered by real banks at hundreds of their offices throughout the country. Commercial firms that currently own ILCs, like General Motors and BMW, would also be permitted to expand.

Additionally, banks and securities companies would be allowed to set up new ILCs, an option many would likely take advantage of because of the decreased regulatory burden and the prospect of a national market. This risk may pose even greater threats to the financial system. If large financial firms were to place their commercial banks under ILC oversight rather than Federal Reserve oversight, this could rapidly increase the number of ILCs and dilute the number of large financial systems that are subject to the important safety and soundness rules that the current system requires. Although one requirement of the bill could prevent some large commercial firms from branching de novo into some states in the future, this minor limitation is overwhelmed by the fact that the overall number of ILCs and the amount deposited in them would likely escalate without a corresponding increase in the oversight of safety and soundness at these institutions. Even worse, while the Federal Reserve Board has the power to examine the parent of a commercial bank and impose capital standards, in an industrial loan company structure only the bank can be examined and regulators can not impose capital requirements on the parent companies.

Specifically, Section 401 of the bill, which broadens the ability of banks to engage in "de novo" branch banking in all 50 states, would permit existing ILCs, including those owned by some commercial and all financial entities, to expand nationally. Regarding ILCs established in the future, the states would be permitted to deny the establishment, acquisition or operation of an ILC branch if they determine that the ILC is directly or indirectly controlled by a commercial firm receiving more than 15 percent of its annual revenue from non-financial sources. Title VII of the bill allows all ILCs to offer checking services to businesses.

We should also note that a Senate bill, S. 1967, would allow industrial loan companies to offer interest bearing checking accounts to businesses. The bill provides that the authority would take effect two years after the date of enactment. There is a requirement that the Secretary of the Treasury and the Federal banking agencies issue joint regulations within 2 years after the date of enactment, but the authority goes into effect after 2 years whether the joint regulations are issued or not. This bill is a straightforward expansion of the authorities of industrial loans companies which we strongly oppose.

Our organizations have several specific concerns with both bills:

**1. The ILC loophole to the Bank Holding Company Act is being abused and should be closed, not expanded.** ILCs were never intended to be large, nationwide banks that offered services indistinguishable from commercial banks. In 1987, Congress granted an exception to the BHCA for ILCs because there were few of them, they were only sporadically chartered in a small number of states, they held very few assets and were limited in the lending and services they offered. In fact, this exception specifically applied only to ILCs chartered in five states (Utah, California, Colorado, Nevada and Minnesota) that have either assets of $100 million or do not offer checking services. Since that time, however, everything about ILCs has grown: the number that exist, the amount of assets and federally insured deposits in them and the services and lending products that they can offer.

According to the Federal Reserve, the majority of ILCs had less than $50 million in assets in 1987, with assets at the largest ILC at less than $400 million. As of 2003, one ILC owned by Merrill Lynch had more than $60 billion in assets (and more than $50 billion in federally insured deposits) while eight other large ILCs had at least $1 billion in assets and a collective total of more than $13 billion in insured deposits. Moreover, the five states cited in the law are aggressively chartering new ILCs, allowing them to call themselves "banks" and giving them almost all of the powers of their state chartered commercial banks. These states, especially Utah, are also promoting their oversight as a less rigorous alternative to those pesky regulators at the Federal Reserve. For example, the web site of the Utah Department of Financial Institutions trumpets its "positive regulatory environment" and states that "ILCs offer a versatile depository charter for companies that are not permitted to, or that choose not to, become subject to the limitations of the Bank Holding Company Act …."

**2. Large financial firms should not be permitted to establish a parallel banking system that is not subject to the rigorous oversight required for real banks.** This represents an enormous and unacceptable risk to taxpayers. Securities firms that own ILCs have taken the lead in promoting the ILC expansions in this bill. They have not been shy about stating that they want to expand ILC powers because they do not want to deal with the regulatory oversight they would face from the Federal Reserve if they purchased a bank, as allowed under the Gramm Leach Bliley Act. Instead, they prefer to set up a "shadow" banking system through ILCs. They want to be able to offer the same services and loans as commercial banks without the same regulatory oversight.

According to the Federal Reserve, however, the deposits in ILC accounts are not as secure as those in real banks. As mentioned above, ILCs are exempt from BHCA, which allows the Federal Reserve to conduct examinations of the safety and soundness not just of banks, but of the parent or holding company of these banks. The BHCA also grants the Federal Reserve the power to place capital requirements and impose sanctions on these holding companies. The Federal Deposit Insurance Corporation (FDIC), which regulates ILCs, does not have these powers.

Oversight of the holding company is the key to protecting the safety and soundness of the banking system. It is immaterial whether the owner of the bank is a financial or a commercial entity. Holding company regulation is essential to ensuring that financial weaknesses, conflicts of interest, malfeasance or incompetent leadership at the parent company will not endanger the taxpayer-insured deposits at the bank. Years of experience and bank failures have shown this to be true.

Moreover, the involvement of investment banking firms in recent corporate scandals has provided plenty of evidence of the need for rigorous scrutiny of these companies as they get more involved in the banking industry. In particular, the participation of some securities firms in the Enron and Wall Street analyst scandals has shown that these firms were rife with conflicts-of-interest that caused them to take actions that ultimately harmed their investors. Given this track record, it would be a serious dereliction of duty on the part of Congress to tie the hands of regulators in looking at bank holding companies.

**3. The bill violates long-standing principles of banking law that commerce and banking should not mix.** Although the "15 percent rule" in the House bill may in some limited situations make it more difficult for some large commercial companies that do not presently own ILCs to acquire, establish or operate an ILC branch in states that move to block this action, it allows a large number of existing commercial ILC parent organizations to expand ILCs nationwide and to offer business checking services without limits. This includes firms such as General Motors, Pitney Bowes, BMW, Volkswagen and Volvo. Moreover, the determination of whether ownership of an ILC is commercial in nature, thus preventing the branching of that ILC into particular states, would be made individually by each state. These are the very states that would likely seek to have ILC branches locate within their borders for economic reasons. The states have a clear conflict-of-interest in making this determination in an accurate manner.

Recent corporate scandals show the serious risks involved in allowing any commercial entity to own a bank without significant regulatory scrutiny at the holding company level. Accounting scandals at Sunbeam, Enron, Worldcom, Tyco, Adelphia and many others involved deliberate deception about the financial health of the companies involved. If these companies had owned banks, not only would employees, investors and the economy have suffered, but taxpayers as well.

**4. ILCs should not be allowed to skirt state restrictions by getting a charter in one of only five states and then branching to other states without their permission.** Right now, only 17 states have agreed under the Riegle-Neal Act's "opt in" provision to a reciprocal arrangement that allows banks chartered in each state to compete in all of them. This means that, under this bill, Congress would be forcing 33 states to allow the entry of under-regulated banks that clearly represent a risk to the companies that might do business with these banks. Congress should not be typing the hands of states that wish to protect their residents from under-regulated ILCs.

### <u>B. Preemption of the voter mandated Constitutional interest rate ceilings in the state of Arkansas is bad policy and unfair to Arkansas voters.</u>

S. 904 would amend the Federal Deposit Insurance Act to remove usury limits currently applicable to Arkansas lenders under the state's constitution. This amendment not only undermines states' rights, it also will mean that Arkansas consumers will pay far more than necessary for credit and risk exposure to discriminatory lending practices. This bill is opposed by a broad coalition of national civil rights, labor and consumer rights organizations (*see* attached letter regarding S. 904 listing these organizations).

The people of Arkansas have determined that there should be a usury limit and have passed one in their state Constitution. Nevertheless, S. 904 deliberately exempts state lenders from this constitutional provision and the express wishes of the people of Arkansas. Despite the clear intent of the majority of voters in Arkansas that they be protected from high interest rates, S. 904 would allow "any other lender" doing business in the state to avoid the interest caps set by the people and the legislature of the state of Arkansas.

The proponents of S. 904 argue that the bill is necessary to remove the Arkansas interest rates caps to make credit more available in the state. Conversely, they argue that as many out-of-state lenders are already permitted to ignore the state usury limits, the bill is needed to bring more jobs to the state from credit facilities that cannot now operate under state law. Opponents of the bill argue that adequate credit is fully available to consumers in Arkansas, that lifting the usury ceiling would simply result in higher priced credit and abusive lending, and that the people of Arkansas should be permitted to determine their own fate on this issue.

<u>*Status of Interest Rate Caps in Arkansas*</u>. Like *most* states, Arkansas has a general usury ceiling that limits the amount of interest that can be charged on loans.[7] Unlike most states, Arkansas has not enacted a series of *exceptions* to the general usury law, allowing for either higher rates of interest, or unregulated interest rates on different kinds of loans. Arkansas is also unusual in that its usury ceiling is set by its state Constitution, rather than by statute, so that change must be agreed to by the voters of the state, rather than simply by the state legislature.

Despite the difficulties in changing the Constitutional provision on usury caps, the voters of Arkansas did change it in 1982, establishing a floating cap of 5% over the Federal Discount Rate.[8] The courts of the state of Arkansas have upheld both the constitutionality and the

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[7]For a general review of the usury laws in the states, their importance, and the exceptions to them, *see* National Consumer Law Center *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000) § 2.4.

[8] Const. Art. 19, § 13(a).

enforcement of this provision repeatedly since its enactment.[9]

*Exceptions to the Usury Ceiling.* There are two ways that loans can be made in Arkansas insured depository institution. As a result of the Gramm-Leach-Bliley Act, banks operating in Arkansas can charge the same rates as out-of-state banks which have branches within the state[10] The second way is for a loan to be made by an out-of-state lender using a loan contract, which includes a *choice of law* provision naming the lender's state as the governing law, so long as the other state has a *reasonable relationship* with the loan transaction.[11]

Availability of Credit in Arkansas. Proponents of S. 904 have argued that because depository institutions can charge unlimited rates of interest, and other lenders cannot, that local lenders have a competitive disadvantage.[12] It has also been intimated that because of the usury cap in Arkansas, many consumers are turned down for car loans, when-- presumably-- they would have qualified for them if higher interest rates were permitted.[13]

However, if there is real competition for interest rates, then a *ceiling* on interest rates should pose no problem, because lenders would be competing with each other to offer the *lowest* interest rates.

Secondly, all indications are that there is no lack of available credit to Arkansas consumers. Conversations with the leading consumer lawyers in the state indicate that there are no complaints from consumers about lack of access to credit. In fact, just the opposite is evident to these long-time consumer advocates-- **recent decreases in interest rates have led to the increased availability of low priced car financing, enabling many more consumers to afford car loans than in recent history.**[14]

*Effect of Interest Rate Ceilings on Jobs In Arkansas.* Some jobs in the credit industry might be gained in Arkansas if the usury ceiling were lifted. Creditors located outside of the state could relocate in the state and make the loans directly, without having to invoke the legal fiction of the *choice of law* provision in the contract. However, the question is--how many jobs? And, at what cost to Arkansas consumers?

[9] *See, e.g., Luebbers v. Money Store, Inc.* 344 Ark. 232, 40 S.W. 3d 745 (2001).

[10] Pub. L. No. 106-102 (199), Section 731, *amending* 12 U.S.C. § 1831u(f).

[11] *Evans v. Harry Robinson Pontiac-Buick, Inc.* 336 Ark. 155, 983 S.W.2d 946 (1999).

[12] *See* Letter to Senators Shelby and Sarbanes from Senator Blanche Lincoln, September 16, 2003.

[13] *See* Letter to Senators Lincoln and Pryor from Jeb Joyce, representing the Arkansas Fair Credit Coalition, October 20, 2003.

[14] Conversation with Susan Purtle, consumer attorney with Legal Aid of Arkansas, October 21, 2003; conversation with Mona Teague, Executive Director of Legal Aid of Arkansas, October 16, 2003; conversation with Jean Turner Carter, Executive Director, Center for Arkansas Legal Services, October 10, 2003. This sentiment was expressed by other consumer attorneys in Arkansas as well.

First, the cost to Arkansas consumers. If S. 904 passes, Arkansas would be at the complete opposite end of the spectrum for consumer protections compared to its current position. Instead of having the most protective of state statutes, it would have the least. If S. 904 passes, **unlike every other state in the union, Arkansas will have absolutely no usury ceiling, and no legal way of ever imposing any limits on interest rates.**

The number of jobs that would be gained in Arkansas if S. 904 passes is speculative, at best. However, even if creditors make a firm promise to move a specific number of jobs to the state, the people of Arkansas--not Congress--should have the opportunity to determine whether a gain in jobs is an appropriate trade for a dramatic decrease in consumer protections.

*Effect of Interest Rate Ceilings on Discriminatory Lending*. Currently, there is a practice in automobile financing which is the subject of significant litigation. It is alleged in a variety of lawsuits around the nation that car dealers routinely obtain higher referral fees from lenders for loans made to African American borrowers, than occurs on loans made to white borrowers.[15] These kickbacks to the car dealers are then recouped by lenders in the form of higher interest rates on the loans used to finance the cars. However, studies show that in states that have interest rates caps on auto financing, there is less discrimination between borrowers of different races, because there is less room to increase the loan rates to cloak these referral fees.[16] As a result, state interest rate ceilings not only have the effect of keeping interest rates low, they also have the effect of reducing discriminatory kickbacks on car loans. Indeed, these studies have shown that there is less discriminatory impact in Arkansas than in most other states, presumably as a result of the state cap on interest rates.

## C. S. 884 is *NOT* a consumer protection bill--it is solely designed to protect the rent to own industry from meaningful consumer protections.

Despite its name **The Consumer Rental-Purchase Agreement Act of 2003 S. 884** is not what it purports to be; it is *not* a consumer protection bill. This bill only provides protections for industry, not for consumers.[17] Although the bill pretends to advance consumer protections in

[15] *Jones v. Ford Motor Credit Company*, 00 Civ. 8330 (S.D. N.Y.); *Cason v. Nissan Motor Acceptance Corp*., C.A. No. 3-98-0223 (M.D. TN); *Coleman v. General Motor Acceptance Corp*., C.A. No. 3-98-0211 (M.D. TN); *Baltimore v. Toyota Motor Credit Corporation*, CV 01-05564 (C.D. CA); *Smith v. Chrysler Financial Company L.L.C*., C.A. No. 00-6003 (D. N.J.);. In addition, four cases were filed in 2002 against banks. *Osborne v. Bank of America*, C.A. No. 02-CV-364 (M.D. TN); *Russell v. Bank One,* C.A. No. 02-CV-365 (M.D. TN); *Claybrook* v. *Primus Automotive Financial Services, Inc*., C.A. 02-CV-382 (M.D. TN); and *Bass v. Wells Fargo Financial Acceptance, Inc*., C.A. No. 02-CV-383 (M.D. TN); *Rodriguez v. Ford Motor Credit Company*, C.A. No. 01 C 8526 (N.D. IL). Information concerning these cases may be found at **www.consumerlaw.org** and **www.faircreditlaw.com**.

[16] Mark Cohen, *Report on the Racial Impact of GMAC's Finance Markup Policy, In the Matter of Addie T. Coleman v. GMAC*, pp. 22, Aug. 29, 2003.

[17] When S. 884 was first introduced a letter opposing the bill was sent to the entire Senate. The letter was signed by ACORN; Coalition for Responsible Lending; Consumer Federation of America; Consumers Union; International Union, UAW; National Association of Consumer Advocates; National Community Reinvestment Coalition; National Consumer Law Center; National Council of La Raza; U.S. Public Interest Research Group;

rent-to-own (RTO) transactions, in actuality it does no such thing. Instead, the bill preempts the state laws providing the strongest protections for the consumers of these transactions. Congress should not overturn state laws that prevent predatory financial practices.

Rent-to-own businesses are essentially appliance and furniture retailers which arrange lease agreements rather than typical installment sales contracts for those customers who cannot purchase goods with cash or who are unsophisticated about money management. These lease agreements contain several special features. First, the leases are short term, so that "rental payments" are due weekly or monthly. Second, the lease agreements contain purchase options which typically enable the consumers to obtain title to the goods by making an additional payment at the end of a stated period, such as eighteen months. Third, the leases are "at will." In other words, the leases theoretically need not be renewed at the end of each weekly or monthly term.

The RTO industry aims its marketing efforts at low-income consumers by advertising in minority media, buses, and in public housing projects. Statistics from the FTC 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. This attitude is encouraged by RTO dealers who emphasize the purchase option in their marketing even while they are 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 $1000 and $2400 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 1½ to 12 times what a cash customer would pay in a traditional retail store for the same appliance.

**There should be no misunderstanding about S.884: it is *not* designed to protect consumers.** The entire purpose of this bill is to preempt stronger state laws that provide more meaningful consumer protections (*see* Sec. 1018(b)). A cursory reading of the bill might lead one to believe that some of the provisions would actually help consumers. However, a close evaluation reveals that there are no meaningful protections whatsoever in this bill. The section that comes closest to requiring some helpful information to consumers (Sec. 1010), would require disclosures about the cost of the RTO transactions to be displayed on a tag attached to the item. However, the penalty to a dealer for failing to comply with this provision is meaningless--only equaling one quarter of one month's lease payment--thus providing no incentive for dealers to comply with even the minimal protection provided in S. 884.

The RTO customer base, almost exclusively low-income, could certainly benefit from

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Center for Civil Justice of Saginaw, Michigan; Coalition of Religious Communities; Community Legal Services of Philadelphia; Consumers League of New Jersey; Florida Legal Services; Mid Minnesota Legal Assistance; and Mountain State Justice Inc (WV).

meaningful consumer protections from an industry which preys upon consumers' lack of perceived options. Mostly these consumers need protection from high costs and unfair practices. There are numerous ways in which RTO legislation can be improved, none of which are included in a meaningful way in S. 884. Instead, RTO consumers would truly benefit from protections such as the following:

1. **Limitations on the total of payments** that a consumer should be required to pay for the purchase of the item. Some states have these limits already, but many do not.

2. **Limits on "fees"** such as late fees, insurance fees, home pick-up fees, reinstatement fees, and etc. Some states have limits already, many do not.

3. **Reinstatement rights** that clearly allow the consumer to have payments made on previous contracts applied to new contracts for the same types of items. While S. 884 has a minimal provision on this point (Sec. 1005(a)(4)), it provides little protection to consumers, and there is no enforcement mechanism.

4. **Price tag disclosures,** as well as contract disclosures. By the time the customer gets the contract the decision to proceed with the transaction has often been made. Yet, S. 884, while requiring price tag disclosures--in section 1010--does not provide an effective remedy for a dealer's failure to comply with this requirement.

5. **Meaningful penalties** for dealers who violate the provisions of the RTO statute. As the maximum penalties to be assessed against a dealer who violates the minimal *disclosure* requirements of S. 884 is 25% of one month's rental payment, there is virtually no incentive for dealers to comply.

6. A disclosure like the **annual percentage rate(APR)** which shows the consumer the true cost of renting to own, to allow comparison with other methods of purchasing personal items.

7. **Limits on maximum RTO interest rates**, as New Jersey requires.

S. 884 only serves to preempt the state laws of Wisconsin, Michigan, Minnesota, Vermont, North Carolina, and New Jersey--all of which provide more protections to consumers. It does not, in any way, advance consumer protection.

### D. Allowing virtually unlimited diversity jurisdiction in federal courts for national banks and federal thrifts is a bad idea.

The House bill includes a provision (Section 213 of H.R. 1375) which would establish that for diversity purposes in federal court, a savings bank would be considered to be a citizen only in the state in which it has its main office. We understand that the Comptroller of Currency is advocating a similar provision applicable to national banks. Both provisions are very bad ideas--they would clog up the federal courts, and worse, in most states they would create a procedural morass that would likely result in many consumers losing their homes to illegal foreclosure.

These proposals would essentially make the federal courts the collection mills for the federally chartered banks and thrifts. This is not good federal policy. Moreover, it is likely to hurt consumers, as federal courts have been known, on numerous occasions to interpret state laws differently--and in a less friendly fashion--than state courts.

A prime example of how damaging this proposal would be to homeowners and communities is its potential application to the foreclosure process. The procedural requirements to *stop* a foreclosure are complex in many states, often requiring that a separate action be filed to enjoin the foreclosure action while the homeowner's defenses and claims are determined in a separate proceeding. How would this work in a foreclosure situation? If the bank initiated a non-judicial foreclosure against a homeowner, and the homeowner sued in state court to stop the foreclosure, the bank could then remove the consumer's case to federal court based on this new diversity jurisdiction. But the while all these legal maneuvers are worked through, the foreclosure process would continue unabated. This would likely leave homeowners with valid claims to stop foreclosures unable to effectively fight through the procedural morass of state versus federal court jurisdiction, resulting in needless and unfair loss of homes.

The concept of diversity jurisdiction is based on the idea that a person or business which does not have a real presence in the community will not receive a fair hearing in the state court, thus necessitating hearing the dispute in the more "neutral" arena of the federal court. However, this proposal threatens to make a mockery of this basic idea, as the bank or thrift would be "foreign" in name only. The bank or thrift might have hundreds of branches, and employ hundreds of state residents. Yet because of this arcane proposed language to be added to the federal statutes, it would legally be considered to not be a resident of the state.

These proposals are an absurd and cynical use of the federal courts to further tilt the balance of power away from consumers. Both national banks and federal thrifts should be considered residents of the states in which they have a legal presence, for purposes of federal court diversity jurisdiction.

### E. Exempting Mid-Size Banks from Full CRA Exams Would Hurt Communities.

The Community Reinvestment Act (CRA) is an extremely important tool for stimulating bank lending and improving access to banking services for the nation's underserved urban and rural communities. The proposal currently pending before the banking agencies to exempt mid-size banks from important aspects of the CRA compliance examination would significantly undermine this important law. Some in Congress are seeking even broader exemptions that would remove virtually all banks from being required to meet their current CRA standards.

The banking agencies' proposal would revise the definition of "small bank" from any institution with less than $250 million in assets and not part of a holding company with over $1 billion in assets to include all institutions with less than $500 million in assets regardless of holding company size. The CRA examination for small banks has been streamlined since 1995 and focuses predominately on an institution's lending record. For a large bank, the CRA examination is far more comprehensive. In addition to reviewing the institution's lending record, the more comprehensive examination considers the extent to which a bank provides banking services to its entire community and its record of investments. The banking agencies' proposal would reduce the number of banks that are subject to the broader CRA examination by about 50 percent (from 2,236 to 1,105). Should the exemption be raised to banks with $1 billion in assets it would mean a reduction of another 50%, leaving fewer than 600 banks nationwide still covered by the more comprehensive CRA examination standard.

The application of such an exemption would mean that only 12 percent of the nation's insured depository institutions (only 6 percent should the exemption be raised to $1 billion) will undergo agency review to determine how well they are meeting the non-lending banking services needs in their communities. This exemption would also disproportionately affect rural communities and small cities where these mid-sized banks continue to have significant market share.

A mid-sized bank exemption takes away the incentive for these institutions to maintain and open new branches or ATM machines serving the low- and moderate-income families in their communities. It is likely to also undercut the extent to which these institutions offer affordable basic banking accounts often necessary for bringing unbanked households into the financial mainstream or money transfer and remittance services that are particularly important to ethnically diverse communities.

Removing the bank holding company as a factor in differentiating between small and large banks will allow many institutions with sufficient resources to unfairly enjoy a streamlined test and abdicate their responsibilities for providing branches and community development investments and loans in low and moderate income communities. A significant number of banks between $250 and $500 million are part of holding companies with assets considerably above $1 billion. For example, FBOP Corporation is a bank holding company of $11 billion in assets and it has four banks between $250 and $500 million in assets.

While these proposals may be billed as "reducing regulatory burden," they actually work at cross purposes with CRA's statutory mandate that banks, regardless of their size, have a continuing and affirmative obligation to serve the credit and deposit needs of their local communities. We strongly urge, therefore, that mid-sized banks should not be exempted from the comprehensive CRA examination either through legislation or via rulemaking.

### **F. Consumer protections from unfair, deceptive and over-reaching debt collectors should not be reduced.**

There are a number of formal and informal legislative proposals floating around this Congress which would seriously undermine the consumer protections of the Fair Debt Collection Protection 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. Now, when this recession is costing millions of Americans their jobs, more consumers will be struggling to pay their bills, it is 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 HR 3066, the other is a proposal to exempt check diversion companies from coverage of the FDCPA.

**HR 3066.** HR 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 to 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 in which 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. HR 3066 weakens the substantive and procedural protections of the FDCPA.

**Check Diversion Exemption.** 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--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 with which all debt collectors collecting bounced checks are able to comply and still successfully collect. Specifically, check diversion companies have consistently been found 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 which 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 which 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.

## II. Important proposals to update federal laws to protect consumers include:

### G. Make sure the EGRPRA process is 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.[18] We are very concerned that this process will yield results which inappropriately favor industry over consumers.

A fair review cannot be limited to issues which 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."[19]

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.

We have filed extensive comments with the agencies regarding the consumer positions in the EGRPRA process.[20] We ask that the Senate Banking Committee instruct the agencies to ensure that their recommendations will be fair and protective of consumers.

### H. Clarify the Application of the Truth in Lending Act to Bounce Loans

The Federal Reserve Board recently announced new, proposed rules to cover overdraft extensions of credit under the Truth in Savings Act, Reg DD. 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*

[18] 12 U.S.C. § 3311.

[19] 12 U.S.C. § 3311(a).

[20] http://www.federalreserve.gov/SECRS/2004/April/20040427/R-1180/R-1180_462_1.pdf

consumers about the true costs of this credit.

Bounce “protection”[21] is a new form of overdraft protection that some banks are using to boost their non-interest revenue.[22] It is a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit. These plans offer short-term credit at triple-digit rates.[23] 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, and in some cases the bank also charges an additional, per-day fee. The Office of Comptroller of Currency has recognized that bounce loans are credit as defined by TILA.[24] Some state regulators have reached the same conclusion.[25]

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 fail. 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.

There is considerable confusion and misunderstanding among consumers about the rules and obligations of bounce loans. Consumers often do not understand the full cost of these loans, and they do not understand the recurring nature and exorbitant cost of the ongoing use of bounce

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[21]Bounce “protection” is a euphemism used by banks to describe this high-cost credit product.

[22]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.html.

[23]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%. If the consumer pays the overdraft bank in 14 days, which is probably more typical for a wage earner, the APR is 541%. This arrangement is much more expensive than alternatives that most banks offer, such as overdraft lines of credit, linking the account to a credit card, and transfers from savings.

[24]Daniel P. Stipano, Deputy Chief Counsel, Office of Comptroller of Currency, Interpretive Letter #914, September 2001.

[25]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).

loans. Consumers would benefit enormously from application of TILA's open-end disclosure rules to these expensive and deceptive products.

## <u>I. Prohibiting all banks, including state chartered banks, from providing exorbitantly priced pay day loans in violation of state laws.</u>

The Federal Deposit Insurance Corporation has failed to protect consumers and is instead threatening the safety and soundness of state-chartered, federally-insured banks by permitting them to partner with store front payday lenders. These "rent-a-bank" arrangements are designed to allow payday lenders to evade state usury and small loan laws.[26] We urge you to clarify that bank charters are not for rent and to insist that the FDIC take action against state banks involved in payday lending.

The FDIC is the only federal regulatory agency that permits banks it supervises to engage in payday lending with third-party check cashers, pawn shops and payday loan outlets. Following vigorous enforcement by the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve Bank of Philadelphia, no federally-chartered banks or members of the Federal Reserve System align themselves with quick cash payday lenders that charge triple-digit interest rates for small loans and trap vulnerable consumers in perpetual debt.

The FDIC guidelines for state banks engaged in payday loan partnerships do not protect consumers and do not regulate payday lending. Three state banks have joined the ranks of rent-a-bank payday lenders since the FDIC announced its guidelines last July. Their guidelines do not substitute for state usury and small loan laws and do not regulate loans made in partnerships between banks and third-parties. 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% or more of loans back to their payday loan partners.[27]

Payday lenders face growing resistance from state legislatures, especially in states where loans are not legal. In 2004 the Michigan Governor vetoed a safe harbor bill and Georgia legislators passed a tough anti-payday loan enforcement bill. West Virginia refused to enact an industry bill and a bill to legalize payday loans is stalled in Pennsylvania. New York's Attorney General filed suit against County Bank and two of its payday loan partners.

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[26]*See* report from Consumer Federation of America titled *"Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury,"* which documents the failure of the Federal Deposit Insurance Corporation to protect consumers and the safety and soundness of state-chartered, federally-insured banks that partner with store front payday lenders.

[27]The payday loan industry's goal is legal status in every state. Fifteen states prohibit payday lending through operation of usury or loan laws and a growing number of states prohibit retailers from brokering loans for out-of-state banks. 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.

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.

## J. The jurisdiction limits and statutory penalties of the Truth in Lending Act and the Consumer Leasing Act need to be brought up to the 21st Century standard

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.[28] 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.

## K. Credit unions should be permitted to provide check cashing and remittance services to anyone in their field of membership.

All consumers face the problem of skyrocketing bank fees. Numerous studies by our organizations have documented both that bank fees are rising and that credit unions offer a substantially better deal to their members than banks do to their customers.[29]

Yet, America's estimated 11 million or more un-banked and under-banked families (13% of all families) face even greater problems than bank customers do, when they seek to obtain financial services from the high-priced companies that make up the fringe banking system: check cashing stores, rent-to-own stores[30], refund anticipation loan purveyors,[31] payday loan companies, and wire transfer or remittance operators. Some products from banks, such as over-

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[28] *See* Consumer Price Index, Inflation Calculator, U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/bls/inflation.htm.

[29] *See* "Big Banks, Bigger Fees," October 2001, U.S. Public Interest Research Group, finding that "the average annual cost of regular checking at the three hundred largest banks was $266, but only $191 at small community banks, and only $101 at credit unions." Also see "Banks Charge More Fees and Higher Fees Than Credit Unions," Consumer Federation of America, March 1998, available at http://www.consumerfed.org/bankchgpr.pdf The Federal Reserve Board of Governors publishes annual reports to Congress on "Fees and Services of Depository Institutions," finding consistently that fees are rising and that larger multi-state banking institutions impose higher fees than community banks. The Federal Reserve studies at this time do not include credit unions. Its 2003 report is available at http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf and previous reports can be accessed at http://www.federalreserve.gov/boarddocs/rptcongress/

[30] For an archive of materials on rent to own stores *see* http://www.pirg.org/consumer/#rent

[31] *See* "All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans," Consumer Federation of America and National Consumer Law Center, January 2004, available at http://www.consumerfed.org/RefundAnticipationLoanReport.pdf

priced, deceptively marketed "bounce protection," also look more and more like fringe banking products.[32]

We support section 307 of the House bill, which would allow credit unions to offer check cashing and remittance services to anyone in their field of membership, not only to members, increasing competition in two very over-priced financial services. Not only would the consumers who take advantage of the services benefit, so would others, since the competitive effect of the credit union services would lower prices in the marketplace overall.

**Remittances.** The problem of the high cost of remittances especially affects immigrant families. According to Federal Reserve Governor Ben Bernanke, "typical nonbank fees for remittances remain high on an absolute basis, and consumers who deal with the less-scrupulous providers of remittance services may bear a significant financial cost."[33]

According to a recent Pew Hispanic Center report, "Billions In Motion,"[34] while the average cost of remittances has declined significantly (e.g., to just under 10%, or $20 for a $200 wire transfer to Central America), an increase in competition could lower costs even further. As Sheila Bair, then-Assistant Secretary of the Treasury for Financial Institutions pointed out at a conference in 2002, "[t]he industry continues to be dominated by a small number of money transmitters that generally tend to charge higher fees than banks or credit unions. By increasing competition, the price of remittances should continue to drop." The report estimates that a cost reduction to an average of 5% of the amount sent could transfer a billion dollars from high-priced operators to working families.

Credit unions could help provide that competition if they could provide remittance services to any consumer who qualifies to join their field of membership, instead of just to their members. A secondary benefit is that these consumers, frustrated by high bank fees, would be attracted to becoming full –fledged credit union members.

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[32] *See* "Bounce Protection: How Banks Turn Rubber into Gold by Enticing Consumers to Write Bad Checks, An Examination of Bounce Protection Plans." April 2003, Consumer Federation of America and National Consumer Law Center, available at http://www.nclc.org/initiatives/test_and_comm/appendix.shtml/.

[33] "Financial Access for Immigrants: The Case of Remittances." Remarks by Governor Ben S. Bernanke at the Financial Access for Immigrants: Learning from Diverse Perspectives conference, Federal Reserve Bank of Chicago, Chicago, Illinois, April 16, 2004, available at http://www.federalreserve.gov/boarddocs/speeches/2004/200404162/default.htm

[34] *See* "Billions In Motion: Latino Immigrants, Remittances and Banking," the Pew Hispanic Center and the Multilateral Investment Fund, November 2002.

Of course, consumer groups believe that consumer protections for remittances should be provided, regardless of who provides remittance services. For example, the Electronic Funds Transfer act should cover these transfers. There should be a limit on fees, minimum timing requirements for delivery of funds, limits on increases in exchange rate between the time the consumer hands over money and the transmittal is received on the other end. Consumers should get receipts and/or similar documentation and have access to a dispute resolution procedure. The sender should be responsible for losses if the remittance was not delivered to the right person or was delivered in the incorrect amount.

**Check Cashing Services For Non-Members.** When consumers cannot afford bank accounts, they often cash their paychecks at check cashing stores, or even at banks, which also impose high non-customer checking fees[35] Many consumers may not be able to afford high bank fees, if they live from paycheck to paycheck, or they may have previous bounced check activity or other circumstances that prevent them from obtaining a bank account.

These consumers pay significant fees – ranging from 1-20% of face value -- to cash their checks at fringe banking outlets. Fees are highest for personal checks, lower for payroll and government checks. In the last several years, many retail companies, from 7-11 to Wal-Mart— have cashed in on the profitable business. Credit unions could cash checks for consumers in their field of membership at lower cost, while encouraging consumers to become members.

## L. Expand the Electronic Fund Transfer Act to apply to all forms of electronically processed payments.

Payments methods are increasingly converging, but the consumer rights available differ vastly depending on how the payment was initiated. A consumer who pays by debit card, for example, has the protections of the federal Electronic Fund Transfer Act, including a 10-day right of recredit 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 recredit, and thus are at the mercy of their banks or the courts to win a return of disputed funds. When the check is processed using a substitute check, the new Check 21 Act provides a 10 day right of recredit, but the Federal Reserve Board's narrow interpretation of the availability of this right in this proposed

[35] A relatively new and rapidly growing industry is marketing under-regulated payroll cashing cards that work at ATMs but are not connected to bank accounts. Employers lower their check transaction costs and the un-banked find them convenient, but the cards are no substitute for a bank account in terms of the potential for building wealth, nor are they free, since the cost of frequent ATM transactions can easily equal or exceed the cost of a bank account. Consumers
Union has compiled resources on the pitfalls of payroll cards as an alternative. *See*, e.g., "Questions for Employees to Ask About Payroll Cards." By Gail Hillebrand, 2004, available in English at http://www.consumersunion.org/pub/core_financial_services/000920.html and in Spanish at http://www.consumersunion.org/pub/core_financial_services/000921.html

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 stop 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.

**Attachment 1**

**AFL-CIO**
**Americans for Democratic Action**
**American Federation of Teachers**
**Association of Community Organizations for Reform Now (ACORN)**
**Common Cause**
**Consumer Federation of America**
**Consumers Union**
**Lawyers' Committee for Civil Rights Under Law**
**Leadership Conference on Civil Rights (LCCR)**
**National Association for the Advancement of Colored People (NAACP)**
**National Association of Consumer Advocates**
**National Community Reinvestment Coalition**
**National Consumer Law Center**
**National Council of Churches**
**National Council of La Raza**
**National Gay and Lesbian Task Force**
**National Urban League**
**Unitarian Universalist Association**
**United Food and Commercial Workers**
**United Mine Workers of America**
**U. S. Public Interest Research Group**

October 16, 2003

The Honorable Blanche Lincoln
United States Senate
Washington, DC 20510

The Honorable Mark Pryor
United States Senate
Washington, DC 20510

Dear Senators Lincoln and Pryor:

We, the undersigned national civil rights, labor and consumer rights organizations, are writing to express our opposition to S. 904, which will likely be offered as an amendment to the "National Consumer Credit Reporting System Improvement Act of 2003." S. 904 would amend the Federal Deposit Insurance Act to remove usury limits currently applicable to Arkansas lenders under the state's constitution. This amendment not only undermines states' rights, it also will mean that Arkansas consumers will pay far more than necessary for credit and risk exposure to discriminatory lending practices.

The people of Arkansas have determined that there should be a usury limit and have passed one in their state Constitution. Nevertheless, S. 904 deliberately exempts state lenders from this constitutional provision and the express wishes of the people of Arkansas. Despite the clear intent of the majority of voters in Arkansas that they be protected from high interest rates**,** S. 904 would allow "any other lender" doing business in the state to avoid the interest caps set by the people and the legislature of the state of Arkansas.

S. 904 extends most-favored-lender status to non-bank finance companies. The "other lenders" who would be able to evade state credit and usury limits under this amendment would range from car dealers to auto finance companies, buy-here-pay-here subprime auto dealers, furniture stores, home improvement-based mortgage lenders, and appliance and electronic stores. Removal of such usury limits would open the door to unscrupulous and discriminatory lending practices by these lenders.

Recent studies have shown that African-American and Latino consumers are likely to pay higher markups for auto loans than white consumers when usury limits are not in place.1 Several auto finance companies and others have been sued by African-American and Latino consumers for such discriminatory markup practices in a number of states.2 In Arkansas, however, as the constitutional usury limits restrict the ability of automobile dealers to markup higher interest rates at their discretion, this type of discrimination appears to be less of a significant problem.3 Yet, S. 904 would eliminate this protection from discrimination and produce a financial environment where discriminatory pricing could prosper. We urge you not to allow this to occur.

While the amendment appears to only impact Arkansas, it sets a dangerous precedent for overturning the credit laws of all states. While depository institutions are subject to some supervision and examination, non-depository credit companies are less regulated. Many states exempt *banks* from usury and interest rate limits, permitting rates as agreed between the parties to be charged, largely because of the allowed exportation of interest rates by national banks. In contrast, most states have extensive laws and regulations that apply to non-depository institution lenders to protect at-risk consumers who have less bargaining power and to restrain abusive credit practices.

[1] Mark Cohen, *Report on the Racial Impact of GMAC's Finance Markup Policy, In the Matter of Addie T. Coleman v. GMAC*, pp. 22, Aug. 29, 2003.

[2] *Jones v. Ford Motor Credit Company*, 00 Civ. 8330 (S.D. N.Y.); *Cason v. Nissan Motor Acceptance Corp*., C.A. No. 3-98-0223 (M.D. TN); *Coleman v. General Motor Acceptance Corp*., C.A. No. 3-98-0211 (M.D. TN); *Baltimore v. Toyota Motor Credit Corporation*, CV 01-05564 (C.D. CA); *Smith v. Chrysler Financial Company L.L.C*., C.A. No. 00-6003 (D. N.J.);. In addition, four cases were filed in 2002 against banks. *Osborne v. Bank of America*, C.A. No. 02-CV-364 (M.D. TN); *Russell v. Bank One,* C.A. No. 02-CV-365 (M.D. TN); *Claybrook* v*. Primus Automotive Financial Services, Inc*., C.A. 02-CV-382 (M.D. TN); and *Bass v. Wells Fargo Financial Acceptance, Inc*., C.A. No. 02-CV-383 (M.D. TN); . *Rodriguez v. Ford Motor Credit Company*, C.A. No. 01 C 8526 (N.D. IL). Information concerning these cases may be found at www.consumerlaw.org and www.faircreditlaw.com.

[3] Id.

S. 904 ignores this important distinction between banks and non-depository institution lenders.

If the people of Arkansas, or any other state, feel that the state limits on credit charges are hurting access to credit, the people of Arkansas can change those limits. It is entirely inappropriate for Congress to preempt the historical powers of the state to protect consumers in this regard. If the Congress grants this privilege to non-bank lenders in Arkansas, the industry will demand the same preemption privilege for the other forty-nine states. This is a very dangerous and an extremely controversial amendment. We strongly oppose adding this amendment to the Fair Credit Reporting Act bill.

Sincerely,

William Samuel
AFL-CIO

Charlotte Fraas
American Federation of Teachers

Darrell Fagin
Americans for Democratic Action

Maude Hurd
Association of Community Organizations for Reform Now (ACORN)

Chellie Pingree
Common Cause

Travis Plunkett
Consumer Federation of America

Janell Duncan
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Barbara Arnwine
Lawyers' Committee for Civil Rights Under Law

Wade Henderson
Leadership Conference on Civil Rights

Hilary O. Shelton
National Association for the Advancement of Colored People (NAACP)

Ira Rheingold
National Association of Consumer Advocates

John Taylor
National Community Reinvestment Coalition

Margot Saunders
National Consumer Law Center

Bob Edgar
National Council of Churches

Brenda Muniz
National Council of La Raza

Shanna Smith
National Fair Housing Alliance

Matt Forman
National Gay and Lesbian Task Force

William Spriggs
National Urban League

Meg Riley
Unitarian Universalist Association

Patricia Scarelli
United Food and Commercial Workers

Cecil E. Roberts
United Mine Workers of America

Edmund Mierzwinski
U. S. Public Interest Research Group

**cc: The Honorable Richard Shelby**
**The Honorable Paul Sarbanes**