CFAnews

March/April 1997
Volume 22, No. 1
ISSN #0732-8281

Credit Card Debt Imposes Sizeable Burdens

Credit card debt has placed significant burdens on tens of millions of households, and crushing burdens on millions of these family units, according to a report released in February by CFA.

The report, entitled "The Consumer Impacts of Expanding Credit Card Debt," urges both consumers and creditors to reduce credit card debt levels substantially.

"Unlike auto and mortgage loans, most credit card debt has imposed costs, not benefits, on borrowers," said CFA Executive Director Stephen Brobeck, author of the report.

"These costs include not only much of the nearly $400 billion debt, but also more than $60 billion of annual interest and fees related to credit card borrowing," he added.

Using data and research generated by the Federal Reserve Board, by industry, and by academic researchers, the report discusses credit card debt levels in households, the costs of this debt to households, reasons for large credit card debts, and strategies for reducing this debt.

Key Findings Detailed

The following are among the report's key findings:

- In 1996, consumers charged more than $1 trillion on credit cards, with the vast majority of these charges — $835 billion — charged on the four major credit cards.
- At the end of 1996, an estimated $374 to $396 billion of this total was being "revolved," incurring interest obligations. For the past four years, revolving consumer credit has increased at double-digit rates — 11.5 percent in 1993, 18.4 percent in 1994, 22.0 percent in 1995, and 11.8 percent in 1996.
- Among 56 to 60 million households that revolved any debt, the average amount of "revolving" debt was between $6,000 and $7,000.
- In 1996, these households spent well over $60 billion on credit card fees, credit card interest, and related home equity loan interest from refinancing credit card debt. This is an average of more than $1,000 per household, more than the average American household spent on electricity, telephone service, car repairs, or car insurance.
- Lower middle income households are most burdened by credit card debts. Participants in consumer credit counseling service debt management programs in 1995 averaged $25,680 in annual income and over $10,000 in credit card debts. Similarly, Chapter 7 bankrupts average $19,800 in annual after-tax income and credit card debts of $17,544, according to recent research by Purdue University's Credit Research Center.
- A significant minority of households have said they are "very concerned" about "meeting [their] credit card monthly payments." An Opinion Research Corporation survey conducted in 1993, when credit card debt levels were much lower than today, found that 39 percent of all households (and 44 percent of those with incomes between $15,000 and $50,000) expressed great concern.
- Providing evidence of rising financial burdens are increases in annual delinquency rates (well over three percent) and charge-offs (over five percent) on bank card loans, and a record number of personal bankruptcies (over one million) in 1996, especially unusual in a period of economic growth.

Consumers, Creditors Share Responsibility

Consumers and creditors share responsibility for these debt burdens, according to the CFA report.

"While consumers bear responsibility for the debts they incur, credit card issuers have been encouraging consumers to go deep in debt — with marketing tactics that reward those who carry balances and penalize those who pay in full," said Bankcard Holders of America Executive Director Ruth Susswein.

The marketing tactics include, but are not limited to, more than two billion mail solicitations a year, additional telephone solicitations, increases in credit lines regardless of ability to pay, low minimum monthly payments, and increases in cash rebates or shopping credits for card use.

Recently, credit card issuers have targeted less affluent groups with their promotions. From 1993 to 1996, the proportion of households with incomes under $20,000 who received credit card offers rose from 40 percent to 58 percent.

The lack of price competition in credit card markets is the principal cause of the aggressive marketing, according to research cited in the report.

"Credit card issuers can afford to mail billions of solicitations (and pursue other marketing initiatives), absorb charge-offs of more than five percent, and still make generous profits mainly because consumers continue to be willing to pay high credit card rates," Brobeck said.

For the past several years, credit cards have been the most profitable bank product and are an important reason for record bank profitability, he noted.

Strategies To Reduce Debt Burdens Recommended

CFA recommended a number of strategies to respond to credit card debt burdens.

"Creditors must exercise much more restraint in their granting of revolving credit, both in the number of cards they approve and in the credit limits they set on these cards," Brobeck said.

In most cases, he said, they should not approve total credit lines greater than 20 percent of annual income. "They have information that would allow them to place such limits on credit extension," Brobeck said.

If creditors refuse to set such limits, then Congress or state legislatures should consider taking this action, he added.

Brobeck also called on creditors to work with consumer educators to inform credit card users of the costs and likely consequences of unsustainable debt levels.

"The three most important messages to stress are that consumers should not hold credit cards with credit lines exceeding 20 percent of income, that carrying more than $6,000 in credit card debt will likely cost more than $1,000 in interest and fees annually, and that those in trouble should contact their local nonprofit consumer credit counseling service," he said.

In addition, Brobeck criticized efforts by credit issuers to get Congress to severely restrict consumer access to Chapter 7 bankruptcy, where debts can be discharged.

"Households with credit card debts approaching their annual incomes will likely never be able to pay them off," Brobeck noted. "Some of these families will not even be able to pay off the interest on these debts.

"More importantly, if creditors adequately monitored credit use, the large majority of these households would never run up such large credit card debts," he added.

Finally, shutting off the Chapter 7 option would only encourage credit card issuers to extend more credit to moderate income households with large debts, he said.

"It is unseemly for credit issuers to push for bankruptcy restrictions while many are aggressively marketing credit cards and raising credit limits," Brobeck said. "Instead, in cooperation with consumer educators and debt counselors, they should work hard to reduce credit card debt levels."

The report is available for $10, paid in advance, by writing to Credit Card Debt, CFA, 1424 16th Street, N.W., Suite 604, Washington, D.C. 20036.

Telecom Law Fails To Achieve Goals

In the first year since its passage, the Telecommunications Act of 1996 has failed to produce on its central promise — lower prices to consumers through competition, according to a report released in March by CFA, Consumers Union, and the Texas Office of Public Utility Council.

"Consumers have not fared well under the Act," said CFA Research Director Mark Cooper, author of the report. "With cable rates up sharply, basic long distance rates on the rise, pay phone hikes scheduled for 1997, and a reduction in competition through an unprecedented number of mergers, consumers wonder when they will begin to benefit from the Telecommunications Act."

Without action by Congress and the Federal Communications Commission to fine-tune the mechanisms designed to bring consumers the benefits of competition, consumers will come out losers under the act, the report concludes.

The groups presented the report to the Senate Commerce Committee during its March hearings on the new law and called on Congress to "put a stop to the price increases and threats of rate hikes consumers have experienced in the year since the enactment of the law."

"Unfortunately the local telephone companies are making matters worse by pressuring the FCC to raise basic monthly rates dramatically," Cooper said.

Specifically, the local exchange companies have proposed increasing the Subscriber Line Charge at the federal level and "rate rebalancing" — increases in basic service rates — at the state level.

They have also sought to impose large flat rate charges on long distance companies that would inevitably be passed on to consumers and have mounted a vigorous campaign to force all segments of the industry to move toward a form of measured service that combines substantial customer charges with charges for usage.

Finally, they have sought "virtual deregulation of pricing, which would inevitably lead to further cost shifting onto the backs of residential customers as companies seek to hold market share in more competitive high volume markets by shifting costs onto less competitive residential markets," Cooper said.

Based on an analysis of the rate proposals presented by local exchange companies to the FCC, the report concludes that these proposals would have the overall

(continued on page 3)

Problems Persist With Auto Leasing Ads

Problems with deceptive auto leasing advertisements persist despite recent actions by the Federal Trade Commission, state attorney generals, and Federal Trade Commission.

"These ads, which hide important information in a blur of fine print, continue to be a major problem," said CFA Chairman Howard Metzenbaum. "We will continue to press for reforms until this problem is resolved."

The Federal Trade Commission and a number of state attorney generals finalized settlement agreements in February with five major automobile manufacturers designed to improve disclosure of lease costs in auto leasing advertisements.

The agency charged General Motors, Mitsubishi, Honda, Isuzu, and Mazda with deceptive lease advertising as well as with violation of the Consumer Leasing Act's clear and conspicuous disclosure requirement.

Under the settlements, these manufacturers will be prohibited from featuring low monthly payments or low amounts down in large, bold print while hiding additional costs and sometimes contradictory information in the fine print. The settlements also require that all disclosure required by the Consumer Leasing Act be "readable and understandable."

In announcing the settlements, FTC Chairman Robert Pitofsky singled out Sen. Metzenbaum and CFA for special recognition saying, "They have served a valuable role in emphasizing the importance of doing away with the blur in automobile lease advertising and providing readable and understandable disclosures for consumers."

"We commend the FTC and the states for making a serious effort to clean up this problem, but deceptive advertisements continue to air," Sen. Metzenbaum said. "These settlements are an important step in the right direction, but much more is left to be done."

Sen. Metzenbaum was more critical of the Federal Reserve Board, which, he said, "has really not done all that they could and should have done."

In meetings with FTC Chairman Pitofsky and Federal Reserve Chairman Alan Greenspan, Sen. Metzenbaum has continued to press these agencies for further action.

Consumers, meanwhile, are left with little guidance and few protections as they attempt to negotiate the best lease deal.

To help consumers avoid costly end of lease charges and determine the benefits of buying the car, CFA in March released "Driving a Bargain: Coming Out Ahead at the End of your Auto Lease."

This free brochure, prepared by Mary Ponder, is designed to help consumers negotiate the best deal at the end of their lease and to make an informed decision on whether to buy or turn in their leased vehicle.

"Leasing has all the headaches and responsibilities of car ownership, but none of the benefits," said CFA Director of Public Affairs Jack Gillis. "At the end of a lease, you have nothing except the likelihood of some hefty and unexpected charges."

"Driving a Bargain" includes explanations of important lease end terms as well as a simple, four-step plan to help consumers make an informed decision at lease end.

"Right now, with few protections available for leasing consumers, following these steps is about the only way to keep from being taken at the end of your lease," Gillis said.

Copies of the brochure are available by sending a self-addressed, stamped business-size envelope to: Driving a Bargain, P.O. Box 12099, Washington, D.C. 20005.

Consumer Health, Safety Get Mixed Review

Personal injuries from auto crashes are up, as are deaths and injuries from poisonings in the home, but a variety of unhealthy behaviors are on the decline, according to a biennial report on the nation's consumer health and safety.

The report, "The Nation's Health and Safety: A Status Report 1997," was released in March by the Coalition for Consumer Health and Safety. The Coalition is a nine-year-old partnership of 39 consumer, health, and insurer groups that CFA organized and manages.

The report found that, while many preventable injuries are up, Americans are drinking less alcohol and eating less fat and cholesterol. If these healthier behaviors continue, they should contribute to a lower incidence of preventable disease in future years.

On the other hand, one particularly unhealthy behavior, smoking, is on the rise again after decades of decline.

"This is no time to be complacent about the nation's health and safety," said CFA Executive Director and Coalition Chairman Stephen Brobeck. "The Consumer Product Safety Commission, the National Highway Traffic Safety Administration, and other federal injury prevention and health promotion programs need continued funding and political support."

"Preventable deaths, injuries, and illnesses cost our society not only unmeasurable pain and suffering, but also more than $400 billion a year," added Glenn Soden, of Nationwide Insurance Groups.

"There must be a strong message, followed up by concrete action, aimed at young people and their parents on the need to establish healthy behaviors that prevent injuries and illnesses," said Joe Groner of Allstate Insurance Groups.

Perhaps the most disturbing news reported on in the survey is the new increase in smoking. The percentage of all Americans who smoke has risen from 25 percent in 1993 to 25.5 percent in 1994, and the number of high school students who say they currently smoke has increased steadily from 27.5 percent in 1991 to 30.5 percent in 1993 to 34.8 percent in 1995.

Each year, more than 419,000 lives are lost prematurely due to tobacco use. It causes 20 percent of all deaths nationwide and 87 percent of lung cancer deaths.

Personal injuries resulting from car crashes are also on the rise, having increased by five percent from 1994 to 1995. After a decade of decline in alcohol-related crashes, 1995 traffic deaths due to alcohol increased four percent over 1994 — 17,274 people were killed in such crashes.

Safety inside the home is also an increasing problem. Between 1993 and 1995, deaths rose from poisons and from a group of other causes that includes electrocution, explosive materials, hot substances, and dangerous liquids. More than seven million people suffered disabling injuries, and an additional 26,400 died, as a result of home accidents in 1995.

The report also highlights some important good news on our nation's health.

For example, federal focus and funding along with improved and earlier medical treatment have contributed to a dramatic drop of 13 percent in AIDS deaths in 1996 after more than a decade of steady increase in such deaths through 1995. In the first six months of 1996, there were an estimated 22,000 deaths from AIDS, down from 24,900 AIDS deaths over the comparable period in 1995.

The report also notes a general improvement in the nation's diet. Americans now consume about half as much cholesterol per day as 10 years ago. One result of that dietary improvement (combined with advances in medical treatment) is that deaths from heart attack, stroke, and other cardiovascular diseases have declined.

The Coalition is distributing the report to members of Congress, to key federal and state government officials, and throughout the consumer, health, and insurer communities.

CFA Health and Safety Coordinator Diana Neidle oversaw preparation of the report, copies of which are available for $20 prepaid by writing to "The Nation's Health and Safety: A Status Report 1997," Consumer Federation of America, 1424 16th Street, N.W., Suite 604, Washington, D.C. 20036.

Pennsylvania Ordered To Rehear CIGNA Case

In March, CIGNA Corp.'s plan to restructure its property-casualty operations was dealt a major set-back when a Pennsylvania appeals court overturned the regulatory approval of the restructuring and ordered a new hearing on the matter.

"While the court decision does not guarantee a favorable outcome for consumers, it should provide us with an opportunity to analyze relevant data and ensure that policyholders' concerns are heard," said CFA Director of Insurance J. Robert Hunter.

Concerned that its substantial asbestos and environmental liabilities were bringing down its credit rating, CIGNA had proposed splitting off most of these liabilities into a new company. Under the restructuring plan, approved by Pennsylvania Insurance Commissioner Linda Kaiser last year, the new company would write no new business, but instead would be devoted entirely to running off those old claims.

CIGNA committed $1.35 billion in capital and reinsurance to fund the new company, but both CIGNA and the Pennsylvania insurance department refused to provide access to documents necessary to assess whether that is adequate funding.

"What if that's not enough money?" Hunter asked. "Either the state guaranty funds will be forced to pick up the tab for unfunded claims, or, if they refuse, policy holders could end up uncompensated," he said.

That is a very real possibility, Hunter noted, since CIGNA's own analysis shortly before they proposed the restructuring indicated that they had no idea what their ultimate liability on these policies would be.

Intervening in the case, CFA objected to the precedent that such a restructuring would set, raised questions about the adequacy of the funding, and objected to the procedure that was set up to hear the case.

Specifically, CFA had asked Kaiser, a former CIGNA senior counsel, to recuse herself, had requested access to documents, including actuarial reports, that the department provided to CIGNA, and had asked that the hearing be conducted in a trial-like format that would have allowed cross-examination of CIGNA's witnesses.

Kaiser denied all these requests.

In sending the case back to the insurance department, however, the court ordered that Kaiser appoint someone else to hear the case, required that documents be made available, and required that the hearing be conducted in a trial format.

CIGNA has appealed the ruling.

"This is a major victory, but we still have a long way to go before this matter is finally resolved," Hunter said.

CONSUMER FEDERATION OF AMERICA
1424 16th Street, N.W., Washington, D.C. 20036
(202) 387-6121

President: *Richard McClintock*
Chairman: *Sen. Howard M. Metzenbaum*
Executive Director: *Stephen Brobeck*
Associate Director: *Ann Lower*
General Counsel: *Mary Ellen Fise*
Legislative Director: *Mary Rouleau*
Research Director: *Mark Cooper*
Public Affairs Director: *Jack Gillis*
Director of Consumer Protection: *Jean Ann Fox*
State/Local Development Director: *Nancy Register*
Health and Safety Coordinator: *Diana Neidle*
Conference Manager: *Adele Ellis*
Indoor Air Coordinator: *Betty Lepin*
Administrator: *Miguel Carpio*
Executive Assistant: *Lydia Grogan*
Legislative Assistant: *Matthew Gordon*
Office Assistant: *Milena Carpio*

CFA's Insurance Group
Director of Insurance: *J. Robert Hunter*
Life Insurance Actuary: *James H. Hunt*
Insurance Counsel: *Kathleen O'Reilly*

CFAnews Editor: *Barbara Roper*

CFAnews is published eight times a year. Annual subscription rate is $25 per year.

© Copyright 1997 by Consumer Federation of America. CFA should be credited for all material. All Rights Reserved.

Design & Typeset by: Dahlman/Middour Design

Consumer Support Rebounds in 104th Congress

The second session of the 104th Congress adopted a more moderate tone than the bitterly partisan first session, leading to a rebound in consumer support from 1995's record low levels, according to CFA's annual analysis of congressional support.

The Voting Record, released in March, recognized 34 members of Congress — five senators and 29 representatives — as Consumer Heroes for 1996. This recognition is based on their excellent pro-consumer voting records during the second session of the 104th Congress, said CFA Legislative Director Mary Rouleau.

In addition, CFA cited 25 representatives and nine senators as 1996 Consumer Zeroes for their consistent opposition to consumers interests.

The 11 senators who have over their careers compiled voting records of at least 85 percent and the 44 representatives with career ratings of at least 90 percent were recognized as Lifetime Consumer Heroes. They are led by Senators Barbara Boxer (D-CA), Paul Wellstone (D-MN), and Ron Wyden (D-OR) at 90 percent and by Representatives Lucille Roybal-Allard (D-CA) at 98 percent and Patsy Mink (D-HI) at 97 percent.

The 1996 ratings are based on 13 key votes in the House and 14 in the Senate during the second session of the 104th Congress.

"The strident partisanship which dominated the first session of the 104th Congress moderated in the second session, producing mixed results for consumers," Rouleau said.

"Although consumer advocates were once again forced to expend a lot of effort fending off anti-consumer initiatives," she added, "the attack on consumer protections and programs had lost much of its momentum, and the results for consumers were far more favorable than in the previous year."

Pro-consumer Bills Adopted

The session produced several important advances for consumers, including passage of safe drinking water reauthorization legislation, of legislation to improve access to and portability of health insurance, and of a raise in the minimum wage.

However, most of the wins for consumers consisted of fighting off anti-consumer legislation, most notably with the failure of the House to override the president's veto of product liability legislation.

In addition, the House passed several anti-consumer initiatives that failed to become law, including a repeal of the assault weapons ban and burdensome restrictions on nonprofit groups. The Senate rejected constitutional amendments to set term limits and to require a balanced budget.

Consumers also suffered several major defeats in 1996, chief among them passage of an anti-consumer telecommunications overhaul bill. In addition, the sugar program, which costs consumers $1.4 billion per year, was renewed, and the president was given the power of the line item veto.

Reflecting the more moderate tone of the second session, the overall voting record, which had dropped dramatically in 1995, rebounded in 1996.

Overall Support Returns to 1994 Levels

The Senate increased its overall record seven points to 49 percent, while House support rose 11 points to 50 percent. These levels are close to where they were in 1994, but still well below previous year's levels.

Republicans scored bigger gains than Democrats but still trailed Democrats substantially in their consumer support.

Overall Republican support went from nine percent to 25 percent in the House and from 12 percent to 24 percent in the Senate, while support among freshman Republicans increased from 7 percent to 24 percent in the House and from 14 percent to 23 percent in the Senate.

Democratic support, meanwhile, increased from 74 to 78 percent in the House and inched up one point to 78 percent in the Senate.

"Politicians appear to have gotten the message that voters care about issues that affect their pocketbooks and their health and safety," Rouleau said. "Still, while they may have abandoned the most extreme of their attacks on consumer protections and programs, we must remain vigilant against efforts to do incrementally what they couldn't accomplish through a head-on assault."

"With major legislation expected to be moving in the 105th Congress on such issues as electric utility restructuring, financial services modernization, and FDA reform, to name just a few, consumers will need to rely on the support of pro-consumer members to ensure that their interests are given equal weight to the special interests in these debates," she said.

Copies of the report are available from CFA, 1424 16th St., N.W., Suite 604, Washington, D.C. 20036. The cost is $10 prepaid, $5 for nonprofit organizations, and free to members of the press.

1996 Congressional Heroes & Zeroes

Five Senate Heroes voted with consumers 93 percent of the time:

Russ Feingold (D-WI)
Patrick Leahy (D-VT)
Daniel Patrick Moynihan (D-NY)
Harry Reid (D-NV)
Paul Sarbanes (D-MD)

Twenty-nine House Heroes voted with consumers at least 92 percent of the time, including four with 100 percent ratings:

Earl Blumenauer (D-OR)
Elijah Cummings (D-MD)
Juanita Millender-McDonald (D-CA)
Jerrold Nadler (D-NY)
Robert Andrews (D-NJ)
Robert Borski (D-PA)
Sherrod Brown (D-OH)
William Coyne (D-PA)
Lloyd Doggett (D-TX)
Michael Doyle (D-PA)
Floyd Flake (D-NY)
Barney Frank (D-MA)
Luis Gutierrez (D-IL)
Maurice Hinchey (D-NY)
Jesse Jackson, Jr. (D-IL)
Patrick Kennedy (D-RI)
John LaFalce (D-NY)
Bill Luther (D-MN)
Carolyn Maloney (D-NY)
Paul McHale (D-PA)
John Olver (D-MA)
Major Owens (D-NY)
Frank Pallone, Jr. (D-NJ)
Charles Rangel (D-NY)
Lucille Roybal-Allard (D-CA)
Thomas Sawyer (D-OH)
Edolphus Towns (D-NY)
Peter Visclosky (D-IN)
Sidney Yates (D-IL)

Nine Senate Zeroes voted with consumers eight percent of the time or less:

Thad Cochran (R-MS)
Paul Coverdell (R-GA)
Lauch Faircloth (R-NC)
Phil Gramm (R-TX)
Jesse Helms (R-NC)
James Inhofe (R-OK)
Trent Lott (R-MS)
Craig Thomas (R-WY)
Connie Mack (R-FL)

Twenty-five House Zeroes voted for consumers eight percent of the time or less, including two with no pro-consumer votes:

Helen Chenoweth (R-ID)
Bill Emerson (R-MO)
Wayne Allard (R-CO)
Cass Ballenger (R-NC)
Joe Barton (R-TX)
John Boehner (R-OH)
Richard Burr (R-NC)
Michael Crapo (R-ID)
Barbara Cubin (R-WY)
Jay Dickey (R-AR)
David Funderburk (R-NC)
Richard Hastings (R-WA)
Joel Hefley (R-CO)
Wally Herger (R-CA)
Walter Jones, Jr. (R-NC)
Greg Laughlin (R-TX)
Frank Lucas (R-OK)
John Mica (R-FL)
Sue Myrick (R-NC)
Richard Pombo (R-CA)
Toby Roth (R-WI)
Dan Schaefer (R-CO)
Cliff Stearns (R-FL)
Bob Stump (R-AZ)
William Thornberry (R-TX)

Telecom *(continued from page 1)*

effect of raising the basic monthly charge paid by residential and small business customers by at least $7 per month, and possibly much more.

"This would create a significant burden on low and middle income households and cost small businesses dearly," Cooper said.

Only consumers in the highest income group consume enough of the more discretionary services, where price reductions might be expected, to offset the increase in basic monthly charges, he explained. All others would be worse off, and low income households would be particularly hard hit.

"These pricing changes are proposed by the local exchange companies for one and only one reason, to keep them whole in the face of competition," Cooper said. "They insist that every penny of investment and operating costs incurred in the past be recovered, and that their revenue streams be virtually guaranteed, in the transition to competition."

"This claim lacks a legal and economic basis and is especially ludicrous in the face of the incredible levels of profits the local exchange companies are earning," Cooper said.

As a group, the major local exchange companies earned a return on equity of 30 percent, almost twice the national average, he noted. The two companies that were immediately allowed into the long distance market with passage of the act doubled their return on equity from about 20 percent to 40 percent.

The report concludes that, if consumers are to see any benefits from the 1996 Act in the near future, it will have to come from a price reductions order by the FCC in its access charge docket.

"This is one area where the commission has the legal authority and evidentiary record to order immediate and substantial reductions in the basic monthly bill that all residential customers pay," said CFA Legislative Director Mary Rouleau.

To that end, the consumer groups have advocated elimination of the subscriber line charge and the pass-through of any reductions in the price long distance companies pay for access to local networks to consumers in the form of reductions in basic long distance rates.

In their letter to the Senate Commerce Committee, the three consumer groups called on Congress to urge the FCC to take the opportunity of access charge reform "to bring down prices for consumers while preserving universal service."

They noted that the FCC has the opportunity "to cut enough 'fat' out of telephone pricing to ensure no consumer faces rate increases for basic monthly service."

"Elimination of above market prices would make it possible to bring down local and long distance rates while ensuring that low income households receive affordable service, rates remain reasonable in rural and remote areas, and there is enough money left over to wire schools, libraries, and rural health facilities," the groups wrote.

Unless excess charges are eliminated, they added, consumers will not receive the concrete benefits they deserve under the act.

Investor Protection Update:

Investment Adviser Rules Need Strengthening

Short-comings in proposed rules to implement the Investment Adviser Supervision Coordination Act of 1996 threaten to undermine the already minimal level of investor protection afforded by the investment adviser laws, CFA warned in February comments to the Securities and Exchange Commission.

"Although we have disagreed from the outset with the approach Congress chose to take, the declared intention of the legislation is to raise the level of investment adviser oversight," said CFA Director of Investor Protection Barbara Roper. "Without modifications, the SEC rules would instead make a bad law worse."

Rushed together in the last days of the 1996 session, the law divides regulatory responsibility for investment advisers between the Securities and Exchange Commission and the states. Under the new system, scheduled to take effect in July, the SEC will oversee advisers with $25 million or more in assets under management, while the states will oversee smaller advisers.

In implementing the new law, the SEC has proposed "what appears to be a workable general framework both for the initial transition to bifurcated federal and state oversight of investment advisers and for on-going transitions between state and Commission registration," Roper noted.

However, to ensure that this new system of divided regulation does not open up new opportunities for unscrupulous individuals to evade regulatory oversight, CFA urged the commission to more closely coordinate its registration and deregistration procedures with the states. To this end, CFA proposed creation of a one-stop registration system for all investment adviser firms, with a registration database accessible to all state and federal regulators.

"This would both minimize the burdens of registration and switching registration on firms and ensure that no loophole is created that allows unregistered advisers to escape regulatory detection," Roper said.

SEC Rule Would Undermine Uniformity of Regulation

In its comments, CFA was highly critical of the SEC's proposal related to state authority over individual representatives of commission-registered firms.

In particular, CFA urged the SEC to withdraw its proposed definition of investment adviser representative, which, because it is narrower than state definitions, would create separate standards for representatives of large and small firms.

"Such an approach would undermine the legislation's goal of ensuring that all individuals who offer comparable services in a particular state be subject to the same qualifications standards, the same routine background checks, and the same level of regulatory oversight," Roper said. She noted that Congress unquestionably intended state law to prevail in this area.

CFA also called on the agency to withdraw commentary accompanying its rule proposals that calls into question the ability of states to take action against dishonest and unethical business practices by advisers. The SEC interpretation flies in the face of the legislation, which specifically preserves states' authority to enforce rules against deceptive practices, Roper noted.

Because it is likely to cause confusion and to be cited in litigation challenging states' enforcement authority, CFA urged the commission to "immediately withdraw this commentary and reaffirm the authority of states to take action against the full panoply of abusive practices engaged in by investment advisers in their states."

Limits on State Fraud Suits Sought

The same special interest groups that pushed through legislation limiting defrauded investors' ability to recover their losses in federal court is now seeking to extend those limitations to lawsuits brought in state court.

A coalition made up of high tech firms, accountants, venture capitalists, and the securities industry is arguing that legislation is needed to provide uniform national standards for securities fraud lawsuits.

"The federal securities litigation bill placed a series of hurdles in the path of defrauded investors who attempt to recover their losses. It would be premature to extend those requirements to cases brought in state court before we know whether they are reducing victims' recoveries and keeping meritorious cases out of court," Roper said.

Although legislation has yet to be introduced, a bipartisan group of representatives has taken up the cause, writing to the president in March urging his support for state preemption legislation.

Consumer groups — including CFA, the American Association of Retired Persons, Citizen Action, Consumers Union, Public Citizen's Congress Watch, and U.S. Public Interest Research Group — also wrote to the president in March urging him not to lend his name to this anti-investor effort.

"When you vetoed the Private Securities Litigation Reform Act, you said you were not willing to sign legislation 'that will have the effect of closing the courthouse door on investors who have legitimate claims,'" the groups noted in their letter. "Now, under the guise of promoting 'uniform national standards,' the proponents of preemption are asking you to lend your name to efforts that would extend the onerous provision of that Act to lawsuits now being brought in state court."

"At a minimum, we believe that you and Congress should insist on seeing real, conclusive evidence of how the litigation reform act has affected the ability of defrauded investors to recover their losses," the groups wrote. "Until such evidence has been generated, we urge you not to support legislative initiatives that would extend this untested experiment to lawsuits brought under state laws."

Airline Merger Could Cost Travelers Half a Billion

Failure to impose vigorous, pro-competitive conditions on the British Airways-American Airlines alliance could cost travelers in excess of $500 million dollars, according to a report released in February by the Consumer Federation of America.

The report, "Open Skies, Closed Airports," concludes that U.S. policy makers would do a grave disservice to the traveling public if they allow themselves to be pressured into approving the proposed alliance between British Airways and American Airlines as quid pro quo for an open skies agreement with the United Kingdom. "The potential benefit of competition on routes between the United States and the United Kingdom would be lost if the merger were allowed to go forward as now proposed," said CFA Research Director and report author Mark Cooper.

"The literature clearly shows that losing a competitor on a route tends to raise fares by 20 to 40 percent, and the British-American alliance would have at least that much of an impact," Cooper added. "Given the value of traffic between the United States and London, the price increases could be in the neighborhood of half a billion dollars."

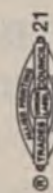
In order to mitigate the anti-competitive impact of the alliance, British Airways and American should be required to give up between 540 and 840 slots at Heathrow airport, about one-quarter of their current holdings, the report concluded. "For a combination of this size, such a remedy to correct anti-competitive problems is typical — analogous to a divestiture of less than 25 percent of the assets of the merging parties in a specific, vulnerable market," Cooper said.

"The fact that an open skies agreement is being linked to the alliance only makes matters worse for consumers," he added. "Open skies agreements should increase the amount of competition, but this alliance would reduce it. The public policy of open skies should be independent of any single commercial deal."

Based on the findings of the report, CFA and Consumers Union, which had earlier urged U.S. policy makers to look carefully at the consumer impacts of the proposed alliance, called for the British Airways-American Airlines combination to be significantly restructured. "One of the ways we can reveal the full implications of this combination is for the Department of Transportation to hold a full evidentiary hearing," said Gene Kimmelman, Co-Director of CU's Washington office. "U.S. policy makers should oppose any alliance that they find directly or indirectly raises airfares for consumers," he added.

CFAnews

Consumer Federation of America
1424 16th Street, N.W. • Washington, D.C. 20036 • (202) 387-6121



BULK RATE
U.S. POSTAGE
PAID
WASHINGTON, DC
PERMIT NO. 8772