CFAnews

JANUARY – FEBRUARY 2008, VOLUME 34, NO. 1, ISSN #0732-8281

CONSUMER FEDERATION OF AMERICA

Insurers Profit by Over-charging Consumers

The property-casualty insurance industry continued to systematically overcharge consumers and reduce the value of home and automobile insurance policies in 2007, according to a report released in January by CFA and a dozen state and national consumer organizations.

The study, written by CFA Director of Insurance J. Robert Hunter, estimates that insurer over-charges over the last four years amounted to an average of $870 per household.

As a result, insurers amassed profits, reserves, and surpluses that are at or near record levels, the report found.

Hunter noted, for example, that the industry reaped record profits in 2004 and 2005, despite significant hurricane activity, that profits rose to unprecedented heights in 2006, and that, "if insurers release even a small part of their swollen reserves as profits, final profits for 2007 will exceed those in 2006."

Meanwhile, the loss and loss adjustment expense (LAE) ratio for 2007 is estimated to be 66.7 percent, the second lowest in 28 years studied. In fact, five of the seven lowest loss and LAE ratios in the last 28 years have occurred since 2003.

"Unfortunately, a major reason why insurers have reported record-high profits and low losses in recent years is that they have been methodically over-charging consumers, cutting back on coverage, under-paying claims, and getting taxpayers to pick up some of the tab for risks the insurers should cover," he said.

For example, insurers have sharply increased premiums or reduced or eliminated coverage for tens of thousands of Americans in coastal areas. Insurers have also succeeded in convincing Congress to continue taxpayer subsidies for terrorism losses and are seeking additional subsidies for natural catastrophes.

Claims Payouts at Record Lows

The report provides extensive data demonstrating that property-casualty insurance companies are paying out lower claims in relationship to the premiums they charge consumers than at any time in decades.

"This drop in the efficiency of the insurance product for consumers is startling and calls for action by the regulators to control industry excesses," Hunter said.

The study also found that retained earnings, or surplus, for the entire industry was at record levels at the end of 2007. "An adequate surplus guarantees a safe insurance industry," Hunter said, "But the current amount is excessive by any legitimate measure."

Even the Insurance Information Institute acknowledges that the industry is over-capitalized by "as much as $100 billion." Hunter puts that number at close to $175 to $200 billion "if reserve redundancies are eliminated."

The Insurance Services Office (ISO) estimates that loss and loss adjustment expense reserves at year-end 2006 were nine percent redundant, a figure that represents over $50 billion in excessive reserves. The CFA report estimates that the redundancy in reserves increased in 2007 and could be up to more than $80 billion by year-end 2007.

"Consumers ultimately pay the price for the unjustified profits, padded reserves, and excessive capitalization that exist right now in the insurance industry," Hunter said. Action by regulators is needed to address those problems, he added.

Policymakers Urged To Act

The report includes specific recommendations for state and federal policymakers. State policymakers are urged to:

• require insurers to offer an all-risk homeowners insurance policy that would once again ensure that homes are protected from catastrophic events, reduce consumer confusion about what their policy covers, and encourage insurers to do more to prevent losses before they occur;

• better oversee the use of socio-economic factors used to set rates, such as credit scoring, to ensure that pricing practices promote risk reduction, are logically related to risk, protect low-income and minority consumers, and are open and transparent to the public;

• increase scrutiny of computer-based claims settlement procedures and stop practices that deny the full payment of legitimate claims;

• make state-backed reinsurance available, thus ending or significantly diminishing the periodic crises that follow big hurricanes or earthquakes;

• consider offering state-backed property and automobile insurance as an alternative to over-priced, limited coverage private insurance;

• better regulate the use of catastrophe modeling, including by blocking catastrophe-modeling firms from using short-term projections as the basis for establishing insurance rates;

• end unjustified geographic discrimination; and

• review homeowners insurance policy forms for hidden provisions, require insurers to offer clear disclosure about exclusions, and lower rates to reflect decreased risk that results from these exclusions.

The report also calls on federal policymakers to: repeal the insurance industry's antitrust exemption; authorize states to use interstate compacts to create multi-state risk "pools" to cover wind and other catastrophic losses; repair the troubled National Flood Insurance Program before vesting it with any additional authority; and eliminate any federal tax policies that might undermine the development of the responsible securitization of insurance risk.

On the **Web**
www.consumerfed.org/pdfs/2008_INSURANCE_RELEASE_FINAL.pdf
www.consumerfed.org/pdfs/2008Insurance_White_Paper.pdf

FDA Allows Sale of Meat and Milk from Cloned Animals

The Food and Drug Administration issued a final report in January declaring food from healthy cloned animals and their offspring to be safe, thus clearing the way for these products to be sold to consumers.

"The pro-cloning juggernaut has successfully turned aside congressional concerns and rolled over consumer opposition," said Carol Tucker Foreman, Distinguished Fellow of CFA's Food Policy Institute.

In an effort to encourage a broader discussion of the issue, CFA had joined with the Center for Food Safety and other consumer and animal welfare groups to petition the Department of Health and Human Services to use its authority to establish an advisory committee to consider moral and ethical issues involved with cloning.

"Surveys have repeatedly shown that consumers are very wary of food from cloned animals," said Chris Waldrop, Director of CFA's Food Policy Institute.

On the same day that FDA issued its report, however, HHS rejected that petition.

Recognizing that negative public reaction could hurt sales both here and abroad, FDA and the U.S. Department of Agriculture have tried to appease consumers by arguing that it is unlikely that milk or meat from clones will actually be sold in the next several years.

The reason, they say, is that clones are too valuable, and it will be several years before the offspring of clones are ready for market. Also, the USDA marketing service has said it will ask cloners to continue to withhold their products from the market.

None of these arguments is adequate to allay consumer concerns, Foreman said. Cloned cows can be milked while somatic cells are being used to produce other clones, and cells from cattle breeding stock can be collected and stored and the animals then slaughtered for food, she noted.

Furthermore, USDA's animal health and marketing agency has no ability to penalize anyone who ignores the voluntary moratorium on a product the FDA has cleared as safe, and USDA does not have commitments from cloning companies not to sell their animals for food, she added.

"Milk and meat from cloned animals will enter the food supply and can do so immediately," Foreman said. "Since the products will not be labeled, consumers will have no way of avoiding them."

The agency's action came in defiance of congressional opposition.

When the Senate adopted its version of the farm bill in December, it included a measure sponsored by Sens. Barbara Mikulski (D-MD) and Arlen Specter (R-PA) requiring the FDA to delay its decision on cloned animals until additional studies can be completed by the USDA and the National Academy of Sciences.

Additionally, Senator Mikulski included language in the fiscal year 2008 omnibus appropriations bill that "strongly encouraged" the FDA to delay any major decision on cloning pending additional studies. The omnibus was signed by the President in December.

"We need a much more comprehensive assessment of the potential implications of allowing food from cloned animals into the food supply," Waldrop said. That assessment should include the impacts on U.S. agriculture, trade, and the integrity of the food supply, all of which "are still largely unknown," he said.

"We simply do not know enough about this technology to allow these products into the food supply unlabeled and untraced," he added.

Unfortunately, Congress was unable to complete work on the farm bill before the end of the 2007 legislative session, and, despite the language in the appropriations package, the agency went ahead with its action during the recess.

On the other hand, both Sen. Mikulski and Rep. Rosa DeLauro (D-CT) have introduced bills to require milk and meat from cloned animals to be labeled (S. 414, H.R. 992) and are seeking to add co-sponsors.

On the **Web**
www.consumerfed.org/pdfs/CFA_Stmt_on_Cloning_Announcement_1_15_08.pdf
www.consumerfed.org/pdfs/FDA_To_Issue_Cloning_Decision_12-18-07_FINAL.pdf

2007 Legislative Update

Energy

CAFE Standards – In a major victory for consumers, Congress passed and the president signed comprehensive energy legislation (H.R. 6, P.L. 110-140) in December that includes the first mandatory increase in vehicle fuel efficiency standards in 30 years. The bill requires an increase in vehicle fuel economy standards by 40 percent to 35 miles per gallon by 2020. This represents a compromise between those who favored stronger provisions – contained in a House bill (H.R. 1506), introduced by Rep. Edward J. Markey (D-MA), and a Senate bill (S. 357), introduced by Sen. Dianne Feinstein (D-CA) – and those who were pushing a weaker, industry-backed alternative (H.R. 2927). In August, the House passed an energy bill (H.R. 3221) that included provisions to promote energy efficiency and the use of renewable fuels but did not include an increase in CAFE standards. After months in which negotiations between the House and Senate appeared to be stalled, an agreement was reached in early December. Following some back-and-forth between the House and Senate over other provisions to be included in the bill, it was passed in mid-December and signed into law.

Renewable Electricity Mandates – The version of the comprehensive energy bill (H.R. 6) that passed the House in early December included a provision that would have required electric utilities to use renewable energy as the source of 15 percent of their electricity. That provision had also been included in the energy bill (H.R. 3221) that passed the House in August. Faced with a presidential veto threat, however, as well as insufficient support to overcome a threatened filibuster, the Senate removed the provision from the energy bill prior to passing it in mid-December, and it was not included in the final bill.

Biofuels – The comprehensive energy bill did include a provision to expand biofuels production. This provision, which was included in both the House and Senate versions of the bill, requires that 36 billion gallons of biofuels be incorporated into gasoline by 2022.

Product Safety

CPSC – Pro-consumer legislation to reform the Consumer Product Safety Commission (CPSC) advanced in both houses of Congress in 2007. In December, the House gave unanimous approval to bipartisan legislation (H.R. 4040), introduced by Rep. Bobby Rush. In October, the Senate Commerce Committee reported out an even stronger bill (S. 2045), introduced by Sen. Mark Pryor (D-AR). Both bills would: require some children's products, including some toys, to be tested by independent labs and to be certified as meeting safety standards; limit the level of lead in children's jewelry and toys and decrease the current lead level for paint coatings on children's products; increase the CPSC's ability to disclose safety information to the public; raise the cap on the agency's civil penalties; and give state attorneys general some ability to enforce CPSC regulations. Both bills also include requirements for catalogue and Internet warning labels and product registration cards. As passed by the Commerce Committee, S. 2045 would go further than the House bill, by eliminating the ability of industry to sue the agency over information disclosure, increasing the cap on civil fines to $100 million rather than the $10 million in the House bill, and including fewer restrictions on the authority of state attorneys general to enforce CPSC regulations. As the session ended, Senate sponsors were negotiating with leading Republicans to win stronger bipartisan support for the bill, with the expectation that a compromise measure would be brought to the Senate floor early in the 2008 session.

CPSC Quorum – Congress passed and the president signed a measure giving the CPSC temporary authority to act in the absence of a quorum. The agency had been without a quorum since January. An amendment, introduced by Sen. Pryor, was added to legislation implementing the recommendations of the 9/11 Commission extending the quorum for an additional six months. That bill passed Congress in late July and was signed into law by the president in early August.

Amusement Park Safety – Rep. Edward J. Markey (D-MA) offered an amendment to the CPSC reform legislation to restore agency authority over fixed-site amusement park rides. The amendment was defeated during committee mark-up.

Nutrition and Food Safety

State-inspected Meat – A compromise measure designed to retain consumer protections while allowing state-inspected meat and poultry products to be sold across state lines was included in the Senate version of the farm bill (H.R. 2419), which passed the Senate in December. The version of the bill that passed the House in July would have ended the 40-year requirement that products shipped in inter-state commerce be federally inspected. It was strongly opposed by CFA and other food safety groups. As passed by the Senate, the measure would create a new inspection program that would allow companies with up to 25 employees that were previously state inspected and that can meet all federal inspection requirements to qualify to sell their products across state lines. Under the program, state inspectors would enforce federal meat and poultry inspections laws in these plants. Each state would have a USDA-employed "state coordinator" who would provide constant federal oversight of the operations in these plants, report to the Secretary of Agriculture if any plant in the program fails to meet federal standards, and stop production and remove from the program any plant that fails to meet the standard. Although both houses had passed versions of the farm bill by year's end, a conference committee was needed to work out differences in the two bills. Both House Agriculture Committee Chairman Collin Peterson (D-MN) and Senate Agriculture Committee Chairman Tom Harkin (D-IA) had pledged to support inclusion of the compromise language in the final bill.

Food Safety Regulation – Sen. Richard Durbin (D-IL) and Rep. Rosa DeLauro (D-CT) introduced legislation (S. 654, H.R. 1148) to create a new Food Safety Administration and consolidate food safety responsibilities within that agency. The legislation would also update food safety laws and provide food safety agencies with additional authority to protect the food supply. CFA endorsed the legislation, which was not acted on during the 2007 session.

Cloned Meat – The version of the farm bill that passed the Senate in December included a measure sponsored by Sens. Barbara Mikulski (D-MD) and Arlen Specter (R-PA) requiring the FDA to delay its decision on cloned animals until additional studies can be completed by the USDA and the National Academy of Sciences. Final passage of that measure was still pending, however, when the FDA announced its conclusion that meat and milk from cloned animals was safe for human consumption, permitting these products to be sold. (See related article, page 1.)

Housing

Predatory Mortgage Lending – The House passed legislation (H.R. 3915) in November to combat abusive practices in the mortgage lending market. Though far from perfect, the bill would: establish a federal duty of care on all mortgage originators; hold loan originators who violate the standard liable; impose limited liability on those who purchase and repackage loans to monitor their quality; strengthen and expand consumer protections under the Homeowners and Equity Protection Act for "high-cost" mortgages; prohibit specific predatory subprime lending practices, including use of prepayment penalties and steering consumers into predatory and other loans they are unlikely to be able to repay. Importantly, the bill leaves states free to adopt higher standards. However, it preempts the use of state law to sue Wall Street securitizers for common abusive practices. Senate Banking Committee Chairman Christopher Dodd (D-CT) introduced a similar but somewhat stronger bill (S. 2452) in late December. The Senate bill would impose liability on investors who buy mortgage-backed securities, while the House bill limits that liability to those who package the securities, and, unlike the House bill, it would not preempt state liability for securitizers. Facing the threat of a Republican filibuster and opposition from the White House, the mortgage reform legislation is likely to face a tough road in the 2008 session.

Mortgage Bankruptcy Reform – The House Judiciary Committee reported out legislation (H.R. 3609) in December that would allow bankruptcy judges to extend the payment period, write down the outstanding principle, or lower the interest rate on unaffordable mortgage loans for consumers facing bankruptcy. As approved, the bill would apply only to subprime or non-traditional mortgages made between January 2000 and the date of enactment. Despite this narrowing of the bill's scope and the fact that it is one of the only measures under consideration that would benefit those currently facing foreclosure, the 17-15 committee vote, a presidential veto threat, and the lack of Senate action all raise questions about the legislation's prospects in 2008.

Insurance

TRIA Extension – In the final days of the 2007 legislative session, Congress passed and the president signed legislation (H.R. 2761, S. 2285, P.L. 110-160) extending the Terrorism Risk Insurance Act (TRIA) for seven years. The House passed its version of the bill, which CFA strongly opposed, in September. The Senate passed a more consumer- and taxpayer-friendly version of the bill in November. The House agreed to the Senate changes in December, and the measure was cleared for the president's signature. Although CFA opposed extension of TRIA in its current form, it viewed the Senate bill as "more responsible" than the House version. Among other things, the Senate version: extends the program for seven years rather than 15; maintains the $100 million trigger level for coverage instead of lowering it to $50 million as the House bill would have done; does not expand TRIA coverage to group life insurance; and does not require coverage of nuclear, biological, chemical, and radiological attacks.

Flood Insurance – Both the House and Senate advanced bills to reauthorize the National Flood Insurance Program (NFIP). The Senate Banking Committee reported out its bill (S. 2284) in November. CFA supported the Senate bill on the grounds that it takes important steps to protect taxpayers, increase the market penetration of flood insurance, and eliminate unjustified subsidies in the flood program. It would require the NFIP to build reserves over time, add a 500-year floodplain to the flood maps, and require the evaluation of flood risk behind dams and

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CFAnews

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

FCC Approves Anti-Consumer Media Ownership Rules

Ignoring requests for a delay from key members of Congress, the Federal Communications Commission approved new rules relaxing media ownership limits on a 3-2 partisan vote in December.

"By rushing the rule out, the Commission has created a political firestorm that obscures the relatively modest changes the Commission has made in media ownership limits," said CFA Research Director Mark Cooper.

Under the new rules, a newspaper and a full power television station can be owned by a single entity in the nation's 20 largest media markets, so long as the deal would leave at least eight other independently owned newspapers or television stations in the city and the television station is not one of the four most-watched television stations in the city.

All other potential mergers would be presumed to not be in the public interest, but proposed mergers would got through a case-by-case review, subject to specific conditions.

"Consumer advocates are concerned that the conditions will not be rigorously applied," Cooper added, "resulting a flood of mergers."

The opposition of consumer advocates, including CFA, to relaxation of the prohibition on newspaper-TV cross ownership forced the Commission to scale back the extent to which such mergers would be allowed.

Among other things, they complained about the rules' lack of clarity. "The proposal's ambiguity leaves it nearly impossible to tell exactly which mergers would be allowed and which mergers would be disallowed, because the criteria by which mergers would be evaluated are completely undefined," CFA, Consumers Union, and Free Press wrote in a statement released shortly before the vote.

The groups had supported efforts in Congress to delay the rules' approval in order to allow more time for public comment. Both Democratic FCC commissioners had criticized the process for failing to allow adequate public input.

Congress Sought Delay

In early December, the Senate Commerce Committee gave voice vote approval to a bipartisan bill (S. 2332) that would have delayed the rule for six months.

Co-sponsored by Sen. Byron Dorgan (D-ND) and Sen. Trent Lott (R-MS), the bill would have required the FCC to conduct a separate proceeding on localism and create an independent minority and female ownership task force before moving forward with any changes to media ownership limits.

Rep. Jay Inslee (D-WA) introduced a companion bill (H.R. 4835), but it was never acted on in the House. However, Commerce Committee Chairman John Dingell (D-MI) did hold a hearing in December at which he urged FCC Chairman Martin to delay approval of the rule.

Now that the rules have been approved, whether consumer interests are protected will depend on how the waiver process is implemented and "whether the agency is willing to carefully scrutinize waivers, rather than simply rubber stamp them," said Gene Kimmelman, Consumers Union Vice President for Federal and International Affairs.

"Unfortunately, the waiver process has been abused under both Republican and Democratic Chairmen," he added, "so getting this right depends on intense scrutiny by Congress and the public."

Congressional scrutiny seems inevitable, given the influence of the members of Congress whose opposition the FCC ignored. In a scathing statement following the agency's vote that accused the FCC of having acted "arrogantly and brazenly," Chairman Dingell promised "rigorous oversight."

On the **Web**
www.hearusnow.org

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levees. In addition, it would create an ombudsman office to investigate problems in the NFIP, including waste and fraud. In contrast to the Senate's pro-consumer action, the House approved flood insurance legislation (H.R. 3121) in September that would dramatically expand the program without taking steps, like those included in the Senate bill, that are needed to reform it. The bill also included a measure, opposed by CFA, to expand the program to cover wind losses. On the other hand, the House gave voice vote approval to an amendment supported by CFA to eliminate the conflict of interest that encourages insurers to refuse to pay legitimate wind claims and to shift the cost of these claims to the NFIP.

Insurance Competition – Pro-consumer bills were introduced in both the Senate and the House (S. 618, H.R. 1081) to give the Federal Trade Commission authority to regulate insurance activities for unfair trade practices. Hearings were held in the Senate Judiciary Committee, but no further action was taken in 2007.

Investor Protection

Internal Controls Reporting – The Senate defeated, but the House approved, anti-investor legislation to weaken a key provision of the Sarbanes-Oxley corporate reform law that requires companies to have adequate systems in place to prevent fraud and ensure accurate financial reporting. In April, the Senate voted 62-35 to table an amendment offered by Sen. Jim DeMint (R-SC) that would have made compliance with the law's internal controls requirements voluntary for virtually all public companies. In June, the House voted 267-154 in favor of an amendment by Rep. Scott Garret (R-NJ) and Rep Tom Feeney (R-FL) to further delay implementation of the requirement for small public companies for an additional year. Although the amendment was included in the Financial Services Appropriations Act (H.R. 2829) that passed the House, it was not approved in the Senate. Ultimately, although no legislation was enacted, the Securities and Exchange Commission abandoned its previous commitment to proceed with implementation and granted another one-year delay.

Stock Option Expense Disclosure – Sen. Carl Levin (D-MI) introduced legislation (S. 2116) in September to require public companies to report the same number for stock option expenses on financial statements as they do on federal tax returns. CFA endorsed the legislation, and hearings were held on the issue, but no further action was taken.

Consumer Credit

Credit Cards – A number of pro-consumer bills were introduced in 2007 to address concerns about credit card abuses. Although the Senate Banking Committee, the Senate Permanent Subcommittee on Investigations, and the House Financial Institutions and Consumer Credit Subcommittee held hearings on the issue, none of these bills were acted on during the first year of the congressional session. Sen. Carl Levin (D-MI) introduced the most comprehensive of the credit card reform bills (S. 1395), which was endorsed by CFA and other consumer groups. It would amend the Truth in Lending Act to curb unjustified penalty interest rate increases, prohibit card companies from raising interest rates on existing balances or balances that have already been paid, limit the ability of issuers to repeatedly assess over-limit fees, bar interest charges on fees, and allow borrowers to pay down debt at higher interest rates first. CFA also supported bills: to stop creditors from collecting fees on payments on credit card accounts via electronic fund transfers (H.R. 873); to improve disclosures and late-fee universal default practices (H.R. 1461); to provide more information to consumers on the consequences of making only minimum payments on credit card debt (S.1176); to stop credit card issuers from taking advantage of student borrowers and their guardians (S. 1925, H.R. 3347); and to ban universal defaults on credit card accounts (S. 1309, H.R. 2146).

Overdraft Loans – Rep. Carolyn Maloney (D-NY) introduced legislation (H.R. 946) to extend the Truth in Lending Act's protections to overdraft loans offered by banks. The bill would require customer consent before a bank could begin charging for the service. It would also prohibit banks from manipulating the order in which they process withdrawals to drive up overdraft fees. CFA endorsed the bill. Unfortunately, although the bill was initially scheduled for a mark-up in the Financial Services Committee, the mark-up was canceled in the face of strong opposition from associations representing small and large banks.

Credit Monitoring – Anti-consumer legislation (H.R. 2885) was introduced in the House to exempt some products offered by credit bureaus, such as credit monitoring, from the consumer protections included in the Credit Repair Organization Act. Hearings have been held on the issue in both the House Energy and Commerce Committee and the Senate Commerce Committee, but no further action was taken.

Payday Lending – Rep. Tom Udall (D-MN) and Rep. Luis Gutierrez (D-IL) introduced legislation (H.R. 2871) in June to prevent payday lenders from gaining electronic access to borrowers' bank accounts, from holding their personal checks, and from lending based on checks or debits drawn on depository institutions. CFA endorsed the bill, but no action had been taken on the legislation by session's end.

Other Financial Services

Industrial Loan Companies – Pro-consumer legislation was introduced in both the House and the Senate (H.R. 698, S. 1395) to prohibit large retail companies from owning Industrial Loan Companies, which are similar to banks but operate outside the bank regulatory system. H.R. 698 passed the full House in May, but it had not yet been taken up in the Senate at year's end.

Financial Regulation – The House approved legislation (H.R. 3526) in December, sponsored by House Financial Services Committee Chairman Barney Frank (D-MA), to expand the ability of federal banking agencies to regulate unfair and deceptive practices. Senate Banking Committee Chairman Christopher Dodd (D-CT) included similar language in his mortgage reform bill, but it was not acted on during the 2007 session.

Telecommunications

Media Consolidation – The Senate Commerce Committee approved bipartisan legislation (S. 2332) in December designed to slow the Federal Communications Committee's rules allowing greater television and newspaper cross-ownership. Despite that action, the FCC went ahead with its rule proposal, although with some revisions designed to make the new rules more palatable to opponents of media consolidation. (See related article, this page.)

Corporate Accountability

Arbitration – Pro-consumer bills were introduced in both the Senate and the House (S. 1782, H.R. 3010) to prohibit pre-dispute binding arbitration of employment, consumer, franchise, and certain other disputes. Hearings were held in both the Senate Judiciary Committee and a House Judiciary subcommittee, but no further action was taken.

Privacy

Identity Theft – In May, the Senate Judiciary Committee reported out pro-consumer legislation (S. 495), introduced by Chairman Patrick Leahy (D-VT), to combat identity theft by requiring notification of security breaches and by increasing criminal penalties for such breaches.

Do-Not-Call List – The House adopted legislation (H.R. 3541) in December to make the list of registrants on the federal Do-Not-Call list permanent and to improve the accuracy of the list.

Mortgage Crisis Dominates Financial Conference

Keynote speakers at CFA's Financial Services Conference in December laid out differing views of the roots of the current mortgage crisis and the appropriate regulatory response.

Martin Gruenberg, Vice Chair of the Federal Deposit Insurance Corporate, offered a historical perspective and concrete policy solutions, while *Washington Post* Staff Writer Steven Pearlstein offered a broader, more philosophical perspective.

The dominance of the 30-year fixed-rate mortgage, which came about after the Great Depression, has eroded rapidly in recent years, Gruenberg said. While these loans accounted for 84 percent of all mortgages in 2001, that percentage had dropped to 55 percent in 2005 and 45 percent in 2006.

Instead, 2/28 loans – which charge a low rate for the first years of the mortgage followed by a large rate increase – have come to dominate the subprime market. They accounted for 70 percent of the subprime market, 55 percent of loans made to African Americans and 47 percent of loans made to Hispanics, he said.

The other transformational event in mortgage market history, he said, is securitization, which has "shifted the risk of these loans to investors worldwide." About 70 percent of all mortgages, including 40 percent of subprime mortgages, are now securitized, he said.

The peak in mortgage resets – where the mortgage resets to the higher interest rate – has yet to come, he said.

"We must address this problem in two ways," he said. First, he said, "we must restore responsible underwriting practices.


Martin Gruenberg


Steven Pearlstein

Loans must be written on the ability to repay. Stated income loans must be discouraged, and there must be more disclosure to consumers of the loan's provisions."

In addition, he said, "we must help the borrowers who are now defaulting on their subprime loans and facing foreclosure." To do that, FDIC Chair Sheila Bair has put forth a proposal to freeze the starter rate of the loans and continue that rate throughout the lifetime of the loan, he said.

Country Lived Beyond Its Means

Pearlstein, who was among the first to predict the wider spread of the mortgage crisis, said it resulted from the fact that "our country lived beyond our means for a long time …

"We had an import bubble, which led to the credit bubble, which led to the real estate bubble, which led to the stock bubble … They all feed one another. Something had to go," he said.

He predicted that, before the crisis is over, home prices will drop by 15 percent, our standard of living will decline by 3 to 4 percent, and that this will lower economic growth, which could even be negative in 2008.

The crisis was predictable and avoidable, he said. "If you've seen the subprime mortgages being given out, you can know something is wrong," he said. "This wasn't being done in secret," he added. Occurrences in the real estate market "were all terribly suspicious."

"In the face of these absurdities, an adult should have said 'stop, this is wrong,'" he added. However, neither industry leaders, nor members of Congress, nor regulators "blew the whistle," he said.

On the other hand, Pearlstein questioned whether regulation could have prevented the problem. "While deregulation has gone too far," and has become "an ideology that's used by special interests to legitimize bad behavior," he said, "regulation is too slow, it's cumbersome, and it has the tendency to get captured by the very interests it was meant to control."

He advocated a more principles-based approach to regulation that gives regulators "a lot more latitude and discretion."

Credit Card Reform Plan Outlined

A third speaker – Columbia University Professor of Law Ronald Mann – outlined a plan for credit card reform in his keynote speech.

"Credit card usage is the most important single predictor of consumer bankruptcy," Mann said. "Given the costs that financial distress imposes on society as a whole, that finding provides a strong case for some form of regulation of the credit card market."

One problem, said, is that credit card lenders can make a great deal of money even when loans are never fully repaid simply by getting borrowers to pay small sums of money for long periods. This "leads naturally to marketing that targets the financially naïve," he said.

The simplest response, he said, would be a ban on marketing directed at minors and college students. But this would deal with only a portion, though an important portion, of the problem.

To address the broader problem, he recommended: raising minimum monthly payments; disclosure "at the point of payment" showing how long it would take to pay off the existing debt if the cardholder continued to make payments at the prior month's level; and developing a standardized credit card agreement.

A standardized form would have three advantages, he said. It would eliminate abusive terms, make it easier for consumers to learn how the agreement works, and focus competition among issuers on a small number of relevant terms that cardholders could understand and evaluate – interest rates, annual fees, grace periods, and "perhaps even customer service."

"I know that my proposals are not the most radical on the table," Mann concluded. "I do think, however, that my proposals are politically realistic, and that they strike at the heart of what is harmful about the credit card."

Consumer Groups Charge IRS Rules Undermine Privacy

The Internal Revenue Service issued a final privacy rule in January that consumer groups condemned for expanding rather than closing "gaping loopholes" that already allow information sharing and marketing based on tax records.

On the same day that the IRS issued its weak final privacy rule, it asked for comments on developing rules restricting the sharing of tax return information to market refund anticipation loans, refund checks, audit insurance, and other high cost products typically sold to low income taxpayers. In a joint statement, CFA, National Consumer Law Center, and U.S. PIRG expressed cautious support for that proposal.

"High cost, risky refund anticipation loans depend on the sharing of tax returns between tax preparers and the banks that provide loans secured by the expected tax refund," explained CFA Financial Services Director Jean Ann Fox. "Almost 10 million consumers lose almost a billion dollars a year from their tax refunds in interest and fees for refund anticipation loans."

Unfortunately, the new privacy rules the IRS issued place the burden for protecting sensitive tax return information on taxpayers instead of prohibiting preparers from sharing tax return information for marketing purposes. The agency rejected recommendations by consumer groups to prohibit tax preparers from trafficking in tax return information for cross-marketing purposes. Instead, the new rule permits tax returns to be sold, shared, or used by both tax preparers' affiliates and third-party companies as long as preparers get signed consent, either on paper or through electronic signatures.

Although the rules make some improvements in consent procedures, the groups questioned their likely effectiveness. Any information shared with third parties would no longer be subject even to modest existing IRS protections, but instead would fall under weaker privacy laws.

In response, the groups urged Congress to take action to guarantee confidentiality of taxpayer records.

On the **Web**
www.consumerfed.org/pdfs/IRS_Privacy_Rule_PR_final.pdf

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CFA's Annual Awards Dinner

June 19, 2008
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