CFAnews

NOVEMBER–DECEMBER 2004, VOLUME 30, NO. 6, ISSN #0732-8281

CONSUMER FEDERATION OF AMERICA

SEC Votes To Clarify Broker-Adviser Distinction

The Securities and Exchange Commission voted unanimously in December to develop a rule clarifying how much investment advice a broker can offer without triggering regulation under the Investment Advisers Act.

"Over the past two decades, the SEC has given brokers virtually unlimited freedom to remake themselves in the image of advisers without requiring them to comply with the investor protection rules that govern advisers," said CFA Director of Investor Protection Barbara Roper.

"This decision by the SEC is the essential first step toward rectifying that situation," she said. "Properly implemented, it will help to ensure that investors can tell legitimate advisers from salespeople masquerading as advisers and that all recipients of investment advisory services receive the same investor protections, regardless of the source of that advice."

The advisers act exempts brokers, but only to the extent that they: 1) limit themselves to giving advice that is "solely incidental" to their primary business of buying and selling securities on behalf of customers and 2) do not receive "special compensation" for that advice.

Marketplace Confusion Result of Past SEC Inaction

Up until now, the SEC has not defined what is meant by "solely incidental" advice.

Instead, it has over the years allowed brokers to offer services, such as financial planning, that are clearly advisory in nature, call their sales reps by such titles as financial consultant and financial adviser, and advertise their services based on the investment advice offered, all without challenging their reliance on the solely incidental exemption.

As a result, financial professionals who are indistinguishable to the average investor have been subject to very different standards of conduct. Specifically, while investment advisers have a fiduciary duty to place their clients' interests ahead of their own, brokers are merely required to make generally suitable recommendations.

Also, brokers do not have to provide the same disclosures, including disclosures about conflicts of interest, that investment advisers must provide, even though those conflicts are arguably greater when advice and product sales are combined.

The SEC action came as part of a decision to re-propose its rule on fee-based brokerage accounts.

Before adopting a final rule, the agency plans to take additional comments on how best to draw the line between brokerage services and advisory services. It has pledged to take final action by April.

Narrow Exclusion Urged

"Whether the Commission's action has its desired effect will depend on how strictly it limits the advisory activities brokers are permitted to offer outside the protections of the advisers act," Roper said. "That is still very much open to question."

CFA has long argued that Congress intended to provide only a very narrow exclusion for the kind of "buy this/sell that" recommendations that are an inherent part of standard brokerage activities.

"Obviously, the exclusion has to cover the activities the broker must engage in to satisfy its know-your-customer and suitability obligations, but it should not extend beyond that," Roper said.

"Any time the broker is offering services, such as financial planning, where advice is the primary service being offered, the advisers act ought to apply," she said.

"Similarly, any time a broker holds out to the public as an adviser or portrays its services as advisory in nature, the advisers act protections should come into play," she added. "To do otherwise would be to allow brokers to actively misrepresent themselves to potential customers."

Public Supports Uniform Regulation of Advisory Services

Creating a narrow exclusion is not only consistent with the law, it also has strong public support, Roper noted.

A survey, commissioned by Zero Alpha Group (ZAG), a network of fee-only advisers, and released jointly by ZAG and CFA in October, found that 91 percent of investors believe brokers who offer investment advisory services should be subject to the same investor protection rules as other investment advisers.

The survey also found widespread confusion among investors about the services offered by brokers, with a majority (53 percent) believing investment advice is either the primary service offered by brokers or of equal importance to transaction assistance. Only a quarter of investors surveyed (26 percent) understood that brokers are primarily salespeople.

"The confusion that exists in the marketplace is the direct result of past SEC inaction," Roper said.

"The Commission has an historic opportunity to restore fairness and simple common sense to the regulation of financial professionals," she added. "Only time will tell whether it will take that opportunity to create a meaningful functional distinction between brokers and advisers.

"In the meantime, the Commission is to be congratulated for taking the essential first step toward achieving that goal."

On the **Web**
http://www.consumerfed.org/statement_on_SEC_solely_incidental_proposal.html
http://www.consumerfed.org/bdrule_Donaldson_ltr_100504.pdf
http://www.consumerfed.org/bdrule_comment_ltr_091704.pdf
http://www.zeroalphagroup.com

FCC Issues Anti-consumer Telephone, Internet Rules

Continuing to pursue its deregulatory agenda, the Federal Communications Commission has voted both to expand the Bell company stranglehold on "last-mile" facilities for high-speed Internet and to end many of the discounts the Bell companies must give local phone competitors.

The former move came in October, with a Commission vote to end the requirement that the Bell companies share certain fiber-optic broadband networks with rivals.

That decision "will curtail the ability of facilities-based competitors to access the fiber necessary to provide advanced services and will result in higher prices and slower innovation," CFA and Consumers Union charged in a joint statement on the decision.

The move brings the country closer to a marketplace where local cable and telephone providers are able to dominate the consumer Internet market, the groups said.

"This stranglehold will stifle innovation as these duopolies discriminate against unaffiliated applications and services that in the past have driven the growth of the Internet and the boom in information technology," said CFA Research Director Mark Cooper. "As a result, our country will fall even further behind Asia and Europe in broadband penetration."

The action on local telephone competition came in December, with a 3-2 vote to phase out by early 2006 the discounts Bell companies must provide local competitors.

Last March, the U.S. Appeals Court for the District of Columbia overturned the FCC's local access rules and issued a harsh rebuke to the agency for failing to heed its earlier instructions.

Most observers believe the new rules will also end up in court. For one reason, the agency failed to conduct the market-by-market analysis that the court had ordered to determine where rivals were unable to do business without access to the Bell networks.

CFA and the Texas Office of Public Utility Counsel (OPUC) performed such an analysis, which they submitted in comments to the FCC in October.

Their analysis found that allowing Bell companies to stop leasing unbundled switching to local competitors would undermine competition for residential customers, the opposite of what the FCC has said it wants to achieve.

One reason is that "the high cost of switching and the onerous conditions the incumbent local exchange carriers place on transport and aggregation of remotely reaching residential customers make it uneconomic to serve large geographic areas from a single central office," Cooper said.

CFA and OPUC laid out a detailed alternative plan for competitive carriers to transition away from leasing Bell switching via the unbundled network element platform and instead lease the Bell loop (UNE-L).

"If policy makers want more customers to be served by competitive switching, then they can institute policies to extend the reach of central offices by making the use of enhanced extended loops easier," Cooper said. They can do this, he added, "by removing the artificial costs and operational impediments the Bells have imposed on this approach."

The recent FCC decisions are just two "of many critical decisions the agency will make in the year ahead that will define the nature of the telecommunications network in the 21st century," Cooper said.

"Consumer groups and Internet activists are fighting to ensure that the advanced telecommunications network is open, accessible, and affordable for all Americans," he added. "Unfortunately, as these two decisions show, the Bush Administration and its allies in Congress consistently put the interests of corporations ahead of consumers and the public interest."

On the **Web**
http://www.consumerfed.org/Consumers_Face_Higher_Internet_Prices_10.14.pdf
http://www.consumerfed.org/uneremand.pdf

2004 Legislative Wrap-up

Financial Services

Bankruptcy Overhaul – Anti-consumer bankruptcy legislation (H.R. 975) once again failed to win approval in the 108th Congress. The sticking point was a Senate-passed provision designed to prevent abortion protestors from using bankruptcy to escape civil fines and judgments. As in the past, the House refused to pass the bill with the clinic violence provision, and the Senate refused to pass the bill without it. At the heart of the bankruptcy bill is a rigid means test designed to force more debtors to file under chapter 13, thus limiting their ability to make a fresh financial start. The House passed its version of the legislation early in 2003. Although Senate Judiciary Committee Chairman Orrin Hatch (R-UT) had threatened to bring the bill directly to the Senate floor, foregoing committee consideration, that threat never materialized. House leaders tried to force the issue onto the Senate agenda early in 2004, by taking up Senate legislation (S. 1920) granting bankruptcy protections to farmers, substituting the broader House bankruptcy overhaul bill, and sending it back to the Senate for approval. The effort failed when Senate Democrats refused to negotiate on the measure. Ultimately, Congress passed and the president signed the measure (P.L. 108-369) extending Chapter 12. It allows family farmers to restructure their debts without losing their land.

Mutual Fund Reform – Although the House passed broad mutual fund reform legislation (H.R. 2420) at the end of 2003, the Senate never acted on any of its companion bills, and Congress recessed without adopting reform legislation. Nonetheless, congressional attention to the issue — including a series of hearings in the Senate Banking Committee — helped spur the Securities and Exchange Commission to action. The SEC proposed more than a dozen new mutual fund regulations, including strengthened fund governance requirements, better disclosures, and prohibitions on certain abusive practices. Many of these had been adopted by year's end. The governance reforms adopted by the SEC went further than many members of the fund industry, and their allies in Congress, would have preferred, by requiring that fund boards have an independent chairman. Sen. Judd Gregg (R-NH) inserted language in the Senate appropriations bill for the SEC, and then into the omnibus budget bill, requiring the agency to submit a report to the Senate Appropriations Committee justifying the independent chairman requirement. The final report requirement in the omnibus bill was made less onerous than Sen. Gregg's original proposal thanks to the efforts of House Financial Services Chairman Michael Oxley (R-OH) and Ranking Member Barney Frank (D-MA).

Stock Option Expensing – Just two years after Congress included language in the Sarbanes-Oxley Act protecting the independence of the Financial Accounting Standards Board, the House gave overwhelming bipartisan support to legislation (H.R. 3574) to block a FASB rule requiring public companies to show their stock option costs as an expense on financial statements. The bill would have limited reporting to those stock options granted to the five highest ranking executives, using a formula for computing the cost that grossly underestimates the value of the options. A Senate companion measure (S. 1890) attracted strong bipartisan support, but Banking Committee Chairman Richard Shelby (R-AL) remained a staunch proponent of FASB independence and refused to move the bill through his committee. With legislation stalled in this Congress, opponents of the rule turned their efforts toward winning a delay in its implementation. In October, FASB succumbed to the pressure and voted to delay implementation of its rule until June 15, 2005. This gives the rule's opponents a new opportunity in the next Congress to try to block the rule.

SEC Civil Enforcement Authority – Both the House and Senate considered legislation in the 108th Congress to enhance the SEC's civil enforcement authority, but the legislation was never adopted. The House bill (H.R. 2179) originally stalled in the Financial Services Committee, when sponsor Rep. Richard Baker (R-LA) included a provision preempting state securities enforcement authority. Although the committee ultimately approved the bill without the preemption provision, the bill was never brought to the House floor for a vote. Meanwhile, the House never took up the Senate-passed CARE Act, which contained the civil fines provisions adopted in the House bill.

Abusive Sales To Military – The House passed legislation (H.R. 5011) in October to ban the sale of high-cost contract mutual funds to members of the armed forces. The legislation also would have given state insurance regulators authority to oversee insurance sales on military bases and would have created a registry of barred insurance agents and securities salespersons to be shared with federal and state regulators and with military bases. A bipartisan companion bill (S. 2905) was introduced in the Senate in October but was not acted on. In September, Senate Banking Committee Chairman Richard Shelby (R-AL) and Ranking Member Paul Sarbanes (D-MD) wrote to the Government Accountability Office, requesting a study of the marketing and sale of financial services products at military bases. They also wrote to the Securities and Exchange Commission, requesting an investigation of possible illegal mutual fund sales practices. The issue is expected to receive renewed attention in the next Congress.

Terrorism Insurance – The House Financial Services Committee gave voice vote approval in September to legislation (H.R. 4634) that would have prematurely extended the Terrorism Risk Insurance Act for an additional two years. The move came before the results are in from a Treasury Department study, mandated by the original act, to determine whether an extension of the legislation is needed. The insurance industry has sought early renewal of TRIA, claiming that the immediate extension is necessary to prevent market disruption. CFA research contradicts that assertion. Both the House bill and a companion measure in the Senate (S. 2764) would have extended the act through 2007. The Senate version also included a "soft landing" provision that would have allowed policies written before the expiration date to keep the federal backstop until they expired. In the waning days of the session, Rep. Richard Baker (R-LA) tried but failed to add the TRIA language to the House intelligence overhaul. In the Senate, Banking Committee Chairman Richard Shelby (R-AL) has appropriately resisted pressure to take up the measure before the results of the Treasury study are in.

Insurance Regulation – Members of both houses began laying the groundwork for an overhaul of insurance regulation, an issue that is expected to pick up steam in the next Congress. In the House, Financial Services Committee Chairman Michael Oxley (R-OH) circulated a discussion draft of anti-consumer deregulation legislation. The bill would have deregulated prices and removed state controls on territorial line-drawing, thus opening the door to redlining. States would have been prevented from stopping the misuse of "risk classification" information for pricing purposes. And only the state of domicile of commercial policy holders would have been permitted to regulate the terms of these policies. Two other industry-backed measures would have created an optional federal charter, precipitating a race to the bottom in regulatory standards between state and federal regulators. The only proposal introduced that took consumer concerns into account was a Senate bill (S. 1373), which was introduced in 2003 by Sen. Ernest F. "Fritz" Hollings (R-SC). Although Chairman Oxley had hoped to mark up his bill this year, no action was taken on any of the measures.

GSE Regulation – Accounting scandals at Fannie Mae and Freddie Mac gave renewed momentum to efforts to overhaul regulatory oversight of the mortgage finance Government Sponsored Enterprises. However, no consensus emerged on the best approach. The Senate Banking Committee approved legislation (S. 1508) in April that would have established a new safety and soundness regulator for the GSEs with the power to raise minimum capital requirements and approve the GSEs' entry into new lines of business. The Committee also unanimously adopted provisions to toughen the GSEs' affordable housing goals and to earmark a portion of the GSES' annual earnings for direct investments to spur the construction of affordable housing. That bill went no further, however, as it faced opposition from nearly all Democrats as well as from the administration. There was also no further action on House legislation (H.R. 2572), which also was stalled by White House objections in late 2003. The issue is expected to be a priority in 2005.

OCC Preemption – The Office of the Comptroller of the Currency adopted rules in 2004 blocking state enforcement of most state consumer protection laws against nationally chartered banks and even their state-licensed non-bank operating subsidiaries. In response, the House Financial Services Committee adopted a non-binding amendment to its portion of the budget bill sharply criticizing the OCC rules for increasing OCC responsibility without any corresponding increase in resources. Opponents of the preemption rule made several additional efforts to overturn it. In April, Sen. John Edwards (D-NC) and Rep. Luis Gutierrez (D-IL) introduced identical measures (S.J. Res. 31, S.J. Res. 32, H.R. 4236, H.R. 4237) to repeal the preemption rules. Rep. Brad Sherman (D-CA) offered an amendment to an appropriations measure that would have barred the government from funding a legal defense of the regulations, but later withdrew the amendment. A bipartisan group of House members wrote to House Financial Services Chairman Michael Oxley (R-OH) in July, urging him to bring the anti-preemption measures to a vote. Despite subsequent efforts to amend the Treasury Appropriations legislation in September, opponents of the preemption rule failed to force action on the anti-preemption legislation. In October, Rep. Barney Frank (D-MA) and 25 co-sponsors introduced legislation (H.R. 5251) to limit the OCC's authority to preempt state consumer protection laws.

Predatory Mortgage Lending – Rep. Brad Miller (D-NC) and Rep. Melvin L. Watt (D-NC) introduced legislation (H.R. 3974) to

CFAnews

Consumer Federation of America

1424 16th Street, N.W., Washington, D.C. 20036

(202) 387-6121 • www.consumerfed.org

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

Design & Typeset by: Dahlman/Middour & Nolan Design

protect homeowners from widespread abusive mortgage lending practices. Endorsed by a number of housing and consumer organizations, including CFA, the bill garnered 17 co-sponsors. Meanwhile, Reps. Bob Ney (R-OH) and Paul Kanjorski (D-PA) announced their intention to collaborate on an alternate bill that would tighten existing federal prohibitions on predatory lending, but preempt state authority to act. The issue is expected to be a priority in the next Congress.

Health and Safety

Gun Safety – In a major defeat for gun safety advocates, the assault weapons ban was allowed to lapse in September. In March, the Senate added a reauthorization amendment to legislation (S. 3831) designed to shield gun manufacturers, sellers, and trade associations from civil liability for damages resulting from negligent manufacturing or selling practices. Provisions were also added restricting sales at gun shows and requiring child safety locks on handguns. As a result, gun advocates withdrew their support from the liability bill, which was defeated 8-90. The assault weapons ban reauthorization and other gun safety provisions died with it. In the House, meanwhile, Majority Leader Tom Delay (R-TX) repeatedly refused to put the assault weapons ban (H.R. 3831) to a vote. Instead, two weeks after the ban lapsed, the House passed a bill (H.R. 3193) that would have repealed the District of Columbia's municipal gun control laws. The legislation died when the Senate failed to take it up. On the other hand, Rep. Todd Tiahrt (R-KS) did succeed in inserting a rider into the 2005 omnibus appropriations bill preventing the Bureau of Alcohol Tobacco and Firearm Enforcement from revealing tracing information about gun sellers and dealers to anyone except law enforcement officials engaged in a criminal investigation. No action was taken on legislation (S. 1224, H.R. 2403) that would have required the gun industry to comply with the same type of health and safety regulations as are applied to virtually all other products sold in America.

Country-of-Origin Food Labeling – The House leadership made an unsuccessful last-minute effort to insert language into the 2005 omnibus appropriations bill replacing the mandatory country-of-origin food labeling requirement with a voluntary system. Although mandatory country-of-origin labeling was retained, efforts to speed up implementation of the program from 2006 to 2005 failed.

Food Safety – Democratic lawmakers introduced a number of bills in the wake of the December 2003 discovery in America of bovine spongiform encephalopy (BSE), or "mad cow" disease. Among these was legislation (S. 2007, H.R. 3705) to require livestock to be tested for BSE and other prion diseases and to create an animal identification and trace-back system. The bills would have codified an Agriculture Department ban aimed at preventing downed cattle from entering the food supply and extended the ban to other livestock. They were never acted on. Meanwhile, the Agriculture Department took steps toward initiating testing for BSE and creating an animal identification system, though the department's actions were not as comprehensive as those the legislation would have required or food safety advocates said were necessary.

CPSC Reauthorization – The House failed to act on legislation to reauthorize the Consumer Product Safety Commission. The Senate had passed a bill (S. 1261) on unanimous consent in 2003 that would have provided increased funding for the agency as well as steep increases in the civil penalties the CPSC is able to impose for failure to report product hazards.

Crib Safety – Bills were introduced in both the House and Senate (S. 2016, H.R. 3371) that would have made it illegal to put a crib that doesn't comply with current voluntary and mandatory safety standards into the stream of commerce — either by selling, re-selling, or providing it for use, in a hotel or day care center, for example. CFA endorsed the bill.

Highway Safety – Congress recessed without reaching agreement on the highway bill (H.R. 3550). Among the provisions left on the table were a package of auto safety measures that were adopted as part of the Senate version of the bill. The provisions addressed: vehicle rollover prevention, side impact crash protection, occupant ejection prevention, vehicle-to-vehicle crash compatibility, 15-passenger van safety, child safety measures, and improved consumer access to safety information. A provision was included in the 2005 omnibus appropriations bill prohibiting the Federal Motor Carrier Safety Administration (FMCSA) from exempting foreign trucks and buses from U.S. safety laws. The FMCSA had proposed to give foreign trucks and buses a two-year grace period from the requirement that all cars, trucks, and buses sold or used in the United States meet the U.S. safety standards that were applicable when the vehicle was built. Despite administration opposition, the measure passed the House on a 339-70 vote, was adopted in conference, and was retained in the final bill that was signed into law by the president.

Health Care

Medical Malpractice – Despite a major effort to win passage of legislation (H.R. 5, S. 11) restricting the ability of victims of medical malpractice to recover damages, the anti-consumer measure once again failed to pass. Like similar measures in previous years, the bills would have capped non-economic damage awards in medical malpractice lawsuits. Although the House passed its bill in 2003, Senate sponsors were unable to garner the votes necessary to end debate and bring the bill to the floor for a vote. The Republican leadership then tried, but failed, to pass narrower bills. For example, Senate Democrats prevented a vote on legislation (S. 2061) that would have capped pain and suffering awards at $250,000, limited punitive damages to the lower of $250,000 or twice the amount of economic damages, and limited attorney fees in cases brought against obstetricians, gynecologists and nurse midwives. A cloture vote on legislation (S. 2207) that would have extended liability limits to trauma center personnel as well as OB/GYNs also came up short. The issue is expected to be a priority in the next Congress, where the expanded Republican majority in the Senate could increase its chances of passing.

Corporate Accountability

Class Action Limits – Anti-consumer legislation (H.R. 1115, S. 2062) that would have created new barriers for consumers seeking redress through class action lawsuits gained broad bipartisan support in the 108th Congress, but nonetheless failed to pass. The House quickly passed its bill in 2003. The Senate appeared set to do the same, but Republican leaders' failure to include Democratic supporters in negotiations on the content of the legislation lost them key votes needed to invoke cloture and proceed to a vote. When backers brought a renegotiated bill to the floor in 2004, their refusal to allow Democratic amendments once again cost them crucial votes needed to end debate. Republican leaders pulled the bill from consideration rather than allow votes on several Democratic amendments, including amendments to raise the minimum wage and curb greenhouse gases.

Telecommunications

Media Ownership Rules – Congress included language in the 2004 omnibus appropriations bill (P.L. 108-199) to partially roll back the Federal Communication Commission's media ownership rules, which would have allowed further concentration in already concentrated media markets. The measure, adopted early in 2004, lowered the national audience cap for broadcasters to 39 percent of U.S. households, down from the FCC's proposed 45 percent. That left other media ownership rules, including rules on newspaper-television and radio-television cross-ownership, still in place. This summer, the Senate included language in its defense authorization bill (S. 2400) that would have barred the FCC from proceeding with these rules. The vote came just two days before a U.S. Appeals Court decision overturned them. Meanwhile, opponents of the rules sought to ensure that any broadcast decency legislation, a priority for Republican leaders, would also include the language opposing loosening of the media ownership rules. Ultimately, both measures were stripped from the final defense authorization bill, which the President signed at the end of October. The FCC has until January 2005 to decide whether to appeal the court decision to the Supreme Court or rewrite the rules.

Digital Copyright Protections – In testimony before the House Commerce, Trade and Consumer Protection Subcommittee, CFA and several other consumer groups endorsed legislation (H.R. 107) to restore the rights of consumers to use digital materials, such as DVDs and CDs, in ways protected by traditional copyright laws. The bill would have required CD makers to label their products to inform consumers of any technical restrictions or limitations on their use and would have clarified some of the fair use exemptions that would allow consumers to circumvent copy protections if no copyright violations were involved.

Energy

Energy Bill – Anti-consumer legislation (H.R. 6) designed to implement the administration's energy policy once again failed to pass in the 108th Congress. Although the House passed the conference report at the end of 2003, Senate leaders never found the votes they needed to bring the conference report to the floor for a vote. Several of the bill's provisions were included in the corporate tax bill (P.L. 108-357), including reduced tax rates for energy manufacturers and tax credits for such "renewable" energy technologies as reduced-sulfur refined coal. During June's energy week, House Republican leaders tried to reactivate the energy issue and once again passed omnibus energy legislation (H.R. 4503). However, they were forced to withdraw a bill (H.R. 4529 that would have permitted oil drilling in Alaska's Arctic National Wildlife Refuge. Another bill (H.R. 4545), which would have granted waivers from some Clean Air Act requirements to regions with fuel shortages, fell 51 votes short of passage.

Oil Reserves – In response to sky-rocketing fuel prices, Rep. Bernie Sanders (I-VT) offered an amendment to the Interior spending bill to use the Strategic Petroleum Reserve to help lower the price of gasoline at the pump. The amendment was defeated on a 152-267 vote.

Privacy

Privacy Outsourcing – Two bills were introduced in the Senate to restricting the outsourcing of sensitive personal information abroad. Sen. Bill Nelson (D-FL) introduced legislation (S. 2481) to require disclosure to health and financial services consumers about the foreign outsourcing of sensitive personal information. The bill also would have required federal agencies to develop regulations to ensure the privacy and security of sensitive personal information outsourced abroad and to establish requirements for foreign call centers. Sen. Hillary Clinton (D-NY) introduced a measure (S. 2471) that would have allowed consumers to opt out of transmissions of personally identifiable information abroad. Neither bill was acted on.

Consumers at Risk from Online Payday Lending

Internet payday loans, which involve electronic access to consumers' checking accounts, pose high risks to consumers, according to a CFA survey released in November of 100 Internet payday loan sites.

"Internet payday loans combine the high costs and collection risks of check-based payday loans with the security risks of sending sensitive information over web links to unknown lenders," said CFA Consumer Protection Director Jean Ann Fox.

Online payday loans are marketed through email, online search, paid ads, and referrals.

Typically, a consumer fills out an online applications form or faxes a completed application that requests personal information, bank account numbers, Social Security numbers, and employer information. In addition, borrowers fax copies of a check, a recent bank statement, and signed paperwork.

The loan is then deposited directly into the consumer's checking account, and the loan payment or the finance charge is electronically withdrawn on the borrower's next payday, often within two weeks.

Internet payday loans cost up to $30 per $100 borrowed, the survey found. Thus, a $500 loan costs $150, and $650 is electronically withdrawn from the borrower's checking account when the term of the loan is up.

Many surveyed lenders automatically renew loans by electronically withdrawing the finance charge from the consumer's checking account every payday. If the consumer does not have enough money on deposit to cover the finance charge or repayment, both the payday lender and the bank impose insufficient funds fees.

CFA surveyed a sample of 100 Internet payday loan websites, 58 of which appeared to be lenders and 42 of which were referral sites linking borrowers to other lenders. The survey collected information on loan costs and terms, website information practices, contract terms, and the identity and regulatory status of the lender.

Survey Findings Detailed

The following are among the survey's key findings.

Loans in amounts ranging from $200 to $2,500 were available, with $500 the most frequently offered loan amount.

Finance charges ranged from $10 to $30 per $100 borrowed, with $25 per $100 borrowed the most common rate. That equates to an annual percentage rate of 650 percent for a loan that is repaid within two weeks.

Only 38 sites disclosed the annual interest rates (APR) for loans prior to the customer's completing the application process, while 57 sites quoted the finance charge. Among those that did post the APR, the most frequently posted rate was 652 percent, followed by 780 percent.

Although loans are due on the borrower's next payday, many surveyed sites automatically renew the loan, withdrawing the finance change from the borrower's bank account and extending the loan for another pay cycle, thus adding to the cost paid by the borrower.

At 65 of the surveyed sites, loan renewals were permitted without any reduction in principal. At some lenders, consumers had to take additional steps to actually repay the loan.

Contracts from Internet payday lenders included a range of one-sided terms, such as mandatory arbitration clauses, agreements not to participate in class action lawsuits, and agreements not to file for bankruptcy.

While most sites posted their privacy policy, 18 did not. Of those that did, many authorized information sharing for third-party marketing purposes with no opportunity to opt out except by not applying. More than a quarter of the sites (28) did not offer secure connections on application pages that collect personal financial information.

In attempting to identify the lender, surveyors found a confusing mix of names and addresses on websites, loan documents, and domain registries. Some sites were registered through anonymous domain registries. Consumers had to click through several URLs in the process of using some sites, making it easy to lose track of the actual lender.

Inadequate Consumer Protections Apply

Internet payday loans are delivered and collected through the Automated Clearinghouse System (ACH), the same network of banks and processors used when consumers pay by debit card.

The Federal Electronic Fund Transfers Act and industry self-regulatory rules for ACH transactions give consumers protections and rights when withdrawals are unauthorized or fraudulent.

However, "rules written for preauthorized debits of routine payments, such as monthly mortgage or insurance bills, do not easily fit payday loan transactions," Fox said, "especially when a borrower wants to stop repeated attempts to collect a loan when funds are not available."

CFA surveyors could confirm that only 20 lenders out of 100 surveyed were licensed in their home states, while 28 sites stated a choice of law. These named nine states and three foreign countries, only one of which (California) caps the cost of payday loans.

Some sites claimed that loans are not available to consumers in a handful of states, but loans were routinely offered to consumers located in states where payday loans are illegal and at terms that exceeded limits of some state payday loan laws.

"Internet payday lending is the latest tactic to evade state small loan consumer protections," Fox said.

"Lenders, when they can be located, are clustered in states with lax or non-existent consumer protections or claim to be doing business from outside the United States," she added. "These companies ignore interest rate caps and small loan laws of the states where their customers get loans."

On the **Web**
http://www.consumerfed.org/113004_InternetPaydayLending.html
http://www.consumerfed.org/Internet_Payday_Lending113004.PDF

CFA Urges Repeal of Limit On FTC Insurance Reviews

In the wake of New York Attorney General Eliot Spitzer's investigation into bid rigging, kickbacks, and improper payments in the insurance industry, CFA has called on Congress to repeal the federal law that prohibits the Federal Trade Commission (FTC) from investigating the insurance industry.

"We applaud Attorney General Spitzer for taking on a practice that has been all too common in the insurance industry for decades, the payment of kickbacks by insurers to brokers who are supposed to represent the interests of consumers," said CFA Director of Insurance J. Robert Hunter in October testimony before the Senate Government Affairs Subcommittee on Financial Management.

Under the McCarran Ferguson Act of 1945, states are given sole authority to regulate insurance, and insurers are granted an exemption from federal antitrust laws. In 1981, Congress further limited the FTC to conducting only those insurance studies specifically requested by a congressional committee. "Unfortunately, most of the state insurance commissioners who are charged with overseeing the insurance industry were asleep at the switch while these abuses were occurring," Hunter said.

"Ultimately, the FTC should be unleashed to prosecute unfair and deceptive practices," said CFA Legislative Director Travis Plunkett. "In the short term, however, Congress should immediately restore the FTC's authority to investigate and report on insurance abuses and to offer recommendations for action to the states."

CFA urged Congress not to enact proposals championed by the insurance industry to deregulate insurance. The most prominent of these is a "discussion draft" released in 2004 by House Financial Services Committee Chairman Michael Oxley (R-OH).

Although that proposal would increase the federal role in insurance regulation, it would override many of the important consumer protections that exist at the state level and sanction additional anti-competitive practices by insurance companies. It would not establish minimum federal consumer protections or empower a federal regulator to investigate and prosecute the types of abuses uncovered in Spitzer's investigation. "Federal involvement in insurance regulation should increase protections for consumers, not gut them," Hunter said.

On the **Web**
http://www.consumerfed.org/insurance_brokerage_testimony.pdf

PRSRT STD
U.S. POSTAGE
PAID
WASHINGTON, D.C.
PERMIT NO. 8772

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

Mark Your Calendar

Consumer Assembly
March 10-11, 2005
Washington, D.C.