



C O N S U M E R F E D E R A T I O N O F A M E R I C A

## Enron Collapse Reshapes Congress's Agenda

**T**he surprise collapse of Enron late last year has highlighted the need for reforms long advocated by CFA in a number of areas, including auditor independence and oversight, pensions, securities litigation, and energy policy.

"The Enron debacle isn't just about the sudden bankruptcy of one large, politically connected company," said CFA Legislative Director Travis Plunkett. "It raises far-reaching questions about how Congress could have allowed so many vested interests to seize so much control over how they are regulated, to the detriment of investors, ratepayers, employees, and consumers."

Enron was forced into bankruptcy last December after revelations that it had for years used accounting trickery to hide massive debts and artificially inflate its revenues.

Investors who relied on the company's false assurances of financial health quickly lost billions as the stock price plummeted. Among them were workers whose 401(k) plans were heavily concentrated in company stock.

Given the existence of numerous safeguards designed to prevent misleading corporate disclosures, a key question for policymakers has been why those safeguards failed so miserably in this instance.

"The Enron collapse exposed gaping holes in the system of investor protections that are supposed to ensure accurate and reliable disclosure," said CFA Director of Investor Protection Barbara Roper. "Enron is suddenly Exhibit A, but the problems exposed are in no way unique to Enron or its auditor, Arthur Andersen."

They include: audits that are independent in name only, a lack of effective regulatory oversight for auditors, reduced liability for auditors who abuse the public trust, poor oversight of auditors by corporate boards, inadequate Securities and Exchange Commission resources to police the marketplace, and inadequate accounting rules.

### Comprehensive Audit Reforms Advocated

CFA released a white paper in February outlining a comprehensive set of reforms needed to restore investor confidence in the reliability of corporate disclosures.

In that report, CFA called on Congress to act quickly and forcefully to:

- restore independence to the outside audit by, at a minimum, banning auditors from providing non-audit services to their audit clients, requiring periodic rotation of auditors, and imposing a cooling off period before auditors could work for an audit client;

- improve oversight of the auditing industry either through enhanced SEC oversight responsibility or by creating an independent

regulatory organization for auditors;

- restore liability for auditors who abuse the public trust by repealing the most anti-investor provisions of the Private Securities Litigation Reform Act, restoring aiding and abetting liability for those who contribute to fraud but are not the primary perpetrators, and extending the statute of limitations for securities fraud lawsuits;

- enhance the independence of corporate boards by pressing the exchanges to set strong independence standards for board members and to require that a majority of board members and all audit committee members meet those standards;

- provide adequate funding to the SEC based on a realistic assessment of the agency's workload, including the cost of implementing pay parity; and

- spur improvements to accounting rules by taking steps to ensure the independent funding and governance of the Financial Accounting Standards Board.

"Only a comprehensive package of reforms, with true auditor independence and oversight at its heart, will be adequate to jus-

tify renewed investor confidence in the reliability of corporate disclosures," said Roper in testimony before the House Financial Services Committee in March.

CFA Chairman Sen. Howard Metzenbaum (Ret.) echoed that message in testimony before the Senate Banking Committee. "Clearly, the system is broken, and it is Congress's job to fix it," he said. "Half measures and quick fixes won't do the job."

### Strong Reform Bills Introduced

A variety of bills have been introduced in both the House and Senate to address these issues. Three Democratic bills combine very strong provisions to improve auditor oversight, significant new protections to enhance auditor independence, and an array of other related reforms. They are:

- H.R. 3818, introduced by Rep. John LaFalce (D-NY), House Minority Leader Richard Gephardt (D-M), and 20 additional co-sponsors;

- H.R. 3970, introduced by Rep. John Dingell (D-MI), Rep. Edward J. Markey (D-MA), and four additional co-sponsors; and

- S. 2004, introduced by Sen. Christopher Dodd (D-CT), Jon Corzine (D-NJ), and three additional co-sponsors.

Taking a different approach, Rep. Dennis Kucinich (D-OH) has introduced a bill, H.R. 3795, to create a new, independent bureau within the Securities and Exchange Commission to perform all audits of public companies.

"Each of these bills contains meaningful protections that offer the prospect of real reform," Roper said. "This is exactly the serious, comprehensive approach that the current crisis of investor confidence demands."

Led by Chairman Michael Oxley (R-OH), House Republicans on the Financial Services Committee also introduced a bill, H.R. 3763, that, while broad in scope, does not contain the stronger protections needed.

Specifically, it does not do enough to ensure the independence and effectiveness of the new accounting regulator it creates, and it does no more on auditor independence than codify steps the major accounting firms have indicated they will take voluntarily.

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## Groups Protest Meat Safety Policies

**R**epresentatives of CFA, S.T.O.P. (Safe Tables Our Priority), and other consumer groups held a protest against Bush Administration meat safety policies outside the Agriculture Department in March.

The groups expressed concern that the administration is not responding aggressively enough to a court decision that prevents the government from closing a meat or poultry processing plant for repeatedly failing Salmonella tests.

The Bush Administration has downplayed the impact of the decision, did not appeal it, and has failed to back legislation that would give USDA explicit authority to close plants that fail to limit pathogens.

In addition, USDA officials have suggested they are considering dropping the mandatory testing of ground beef for E. coli 0157:H7, failed to make final the proposed rule on testing for *Listeria monocytogenes*, and refused to set a limit on the pathogen campylobacter.

The protest was held on the same day that companion bills were introduced in the House and Senate requiring the Secretary of Agriculture to set and enforce limits on pathogens in raw meat and poultry products.

Under S. 2013, introduced by Senate Agriculture Committee Chairman Tom Harkin (D-IA), and H.R. 3956, introduced

by Rep. Anna Eshoo (D-CA), USDA would be prohibited from affixing its inspection seal to products from companies that consistently fail the tests.

"Consumers need protection now," said Carol Tucker Foreman, Director of CFA's Food Policy Institute. "But, as of today, USDA has no authority to enforce any standard. This legislation would give them that authority."

CFA has also criticized an earlier decision by USDA to implement changes to the poultry inspection system favored by industry but harmful to consumers.

USDA made the announcement that it was proceeding with the Hazard Analysis Critical Control Point Based Inspection Models Project (HIMP) one day before the release of a highly critical General Accounting Office report.

"This pilot project should be dumped in the garbage along with the dirty chickens it produces," Tucker Foreman said.

HIMP turns over to plant employees certain inspection functions previously performed by USDA. The GAO report found that five of 11 poultry plants participating in

the HIMP pilot project were less successful in controlling Salmonella, and only one met the standard for eliminating visible fecal contamination.

Despite that overwhelming lack of success, USDA is expanding the project to any plant that volunteers for it and is doing so before receiving public comments and publishing regulations.

"The only reason for the administration to go forward after the GAO report is to give in to the poultry industry's pressure to run their production lines faster," Tucker Foreman said. "Faster line speeds result in more fecal material on poultry."

"We have waited to see if HIMP showed improvement in controlling the organisms that cause 76 million cases of food poisoning each year," she said, "but the project did not produce improvements."

Given that pilot project participants knew they were under scrutiny and acted accordingly, problems will only grow "once the project is incorporated into the inspection system and the outside consultants and extra USDA oversight are removed," she added.

### On the Web

[www.consumerfed.org/himp\\_pr.html](http://www.consumerfed.org/himp_pr.html)

[www.consumerfed.org/meatprotest\\_031202.PDF](http://www.consumerfed.org/meatprotest_031202.PDF)

[www.consumerfed.org/lobbyist\\_leave\\_behind\\_sheet1.PDF](http://www.consumerfed.org/lobbyist_leave_behind_sheet1.PDF)

# Microsoft Antitrust Settlement Review Advances

The Microsoft antitrust case moved forward on two tracks in March, with the federal judge simultaneously conducting a public interest review of the proposed settlement and allowing the case by nine states that rejected the settlement to go forward.

CFA and 12 other state and national consumer groups filed comments at the Department of Justice (DOJ) in January criticizing the final judgment proposed by Microsoft and the DOJ as "fundamentally flawed" and urging the District Court to reject it.

"The final judgment needs to stop Microsoft's antitrust violations, deny the company the fruits of its illegal conduct, and prevent further violations," said CFA Research Director Mark Cooper. "What Microsoft and DOJ have proposed does none of the above."

Although DOJ and Microsoft made some changes to the settlement in response to public comments, consumer groups, Microsoft competitors, and the nine non-settling states said they did not solve its fundamental problems.

Along with their comment letter, the

groups submitted a comprehensive, 100-page analysis prepared by CFA and Consumers Union detailing the proposal's myriad shortcomings.

## Proposed Settlement Criticized

That analysis demonstrates that every provision of the proposed settlement has a loophole or is ambiguously worded. As a result, the settlement:

- fails to create an environment in which independent software vendors and alternative platform developers are free to develop products that compete with Windows and with other Microsoft products;
- leaves computer manufacturers vulnerable to retaliation from Microsoft and undermines their incentive to install non-Microsoft products on new PCs; and
- continues to give Microsoft an immense advantage in presenting programs to consumers, which undermines consumers' ability to choose between Microsoft and non-Microsoft products in an unbiased manner.

"CFA has estimated that consumers have already been overcharged between \$20 and

\$30 billion as a result of Microsoft's monopoly abuses," Cooper said. "The problem would grow much worse under the Microsoft-DOJ proposal, because it would allow Microsoft's monopoly power to spread to the Internet."

"Judge Kollar-Kotelly has a strong and workable alternative already before her — that proposed by the state attorneys general continuing to prosecute the case," Cooper added.

"The District Court should not hastily adopt a supposed quick fix" by approving the proposed settlement, he concluded. "Instead, the Court should take the time necessary to impose an effective remedy to end the Microsoft monopolies once and for all."

## Private Settlement Rejected

Meanwhile, consumers scored a victory in the class action lawsuits against Microsoft

when U.S. District Judge J. Frederick Motz rejected a plan that would have allowed Microsoft to settle the lawsuits by donating computers, software, and cash to needy public schools.

In rejecting the settlement, Judge Motz cited flaws also highlighted by CFA and other consumer groups — that the settlement is "critically underfunded" and would have anti-competitive effects on the market.

CFA, Media Access Project, and U.S. Public Interest Research Group wrote to the judge in November urging him to reject the proposed settlement. "Far from remedying the damage, [the proposed settlement] would inflict additional harm upon the injured class of consumers by extending Microsoft's monopoly products and diminishing the effectiveness of the antitrust laws," they wrote.

## On the Web

[www.consumerfed.org/CFA\\_tunney\\_comments\\_20020125.PDF](http://www.consumerfed.org/CFA_tunney_comments_20020125.PDF)

[www.consumerfed.org/Groups\\_tunney\\_comments\\_release\\_20020125.PDF](http://www.consumerfed.org/Groups_tunney_comments_release_20020125.PDF)

[www.consumerfed.org/classaction\\_letter\\_20011127.pdf](http://www.consumerfed.org/classaction_letter_20011127.pdf)

## Enron, Continued from Page 1

"If Congress follows the blueprint laid down by House Republicans and the administration, there's a very real risk that we will end up with another regulator in the hip pocket of industry and no meaningful reforms in the area of auditor independence," Roper said.

The House Financial Services Committee was expected to begin marking up the Republican audit reform bill soon after Congress returns from spring recess. The Senate Banking Committee had not announced a schedule for action.

Bills have also been introduced in both the House and Senate to restore investors' rights in securities litigation.

Both S. 1933, introduced by Sen. Richard Shelby (R-AL), and H.R. 3829, introduced by Rep. Bart Stupak (D-MI), contain the key reforms advocated by CFA. In addition, the LaFalce audit reform bill includes several provisions to restore fraud victims' rights in litigation.

"These bills would restore balance and fairness to the system," Roper said. She acknowledged, however, that such reforms face an uphill battle, given the adamant opposition of key congressional players and the administration.

## Pension Reforms Advance

The compelling stories of Enron employees who watched their retirement savings evaporate have helped to spur quicker congressional action on the issue of pension reforms, but partisan divisions threaten to stall this progress as well.

Competing bills to address 401(k) plan reforms were marked up in the House Ways and Means and Education and Workforce Committees and in the Senate Labor Committee in March. Only the Ways and Means bill, which was approved on a 36-2 vote, garnered bipartisan support.

All three bills — H.R. 3762, introduced by Rep. John Boehner (R-OH), H.R.3669, introduced by Rep. Rob Portman (R-OH) and Rep.

Benjamin Cardin (D-MD), and S. 1922, introduced by Sen. Edward M. Kennedy (D-MA) — would give employees more warning before lockdowns and more freedom to sell company stock held in their retirement plans.

However, the House bills do not go as far as the Senate alternative in preventing excessive concentration in company stock.

One key difference is that the Kennedy bill would prohibit employers from both matching employee contributions with company stock and offering company stock as an investment option within the plan, unless they also offer a traditional pension.

"Employees in 401(k) plans and other defined contribution plans accept all the risk and responsibility for their retirement investments," Roper said. "It goes without saying that employers should not be able to overload their plans with company stock or tie their hands when they try to follow sound investing principles and diversify their holdings."

"Given the enormous risks associated with over-concentrating retirement savings in a single stock, it is not only appropriate, but necessary to prevent employers from encouraging such over-concentration by both matching contributions with company stock and offering it as an investment option within the plan," she added.

Another key difference between the Boehner and Kennedy bills involves how they approach expanding plan participants' access to advice.

The Boehner bill incorporates his legislation, passed last year by the House, which would repeal current pension law protections against biased advice. In an approach strongly favored by CFA, the Kennedy bill would ensure that advice is independent.

"If the Enron fiasco has taught us anything, it should have taught us that conflicts of interest matter," Roper said. "Employees who are desperate for advice to help them make these most important of all investment decisions should not be forced to rely on advice that is

tainted by conflicts of interest," she said.

The House is expected to consolidate its two bills before bringing them to the floor.

## Enron Changes Energy Debate

The Enron collapse has also roiled the debate over electricity restructuring and added energy derivatives regulation to the energy bill debate in the Senate.

Controversy surrounding the energy company's collapse prompted the House to delay consideration of electricity deregulation legislation. Senate Democrats, however, included electricity deregulation provisions in S. 517, the Senate energy bill.

That bill would repeal the Public Utility Holding Company Act before the advent of real competition, a move long opposed by CFA, and replace it with greater authority for the federal government to demand financial data from electricity sellers.

Noting that "failure of disclosure rules was at the core of the Enron fiasco," CFA Research Director Mark Cooper said the "claim that transparency in the electricity market will protect against abuse by educating buyers about the market is easy to state, but hard to accomplish."

Furthermore, he said, if regulators had vigorously implemented the rules of PUHCA, much of the financial manipulation in electricity markets would have been prevented.

"Electricity is too important, the conditions of its supply too demanding, and its vulnerability to manipulation too pervasive to be left to the vagaries of volatile spot markets," Cooper said.

"The primary message from Enron's demise should be that our nation regains a long-term,

socially responsible perspective on electricity," he said.

Such a policy should include: long-term supply commitments based on a long-term relationship between utilities and customers and a requirement that the entity that has the duty to keep the lights on also have a reasonable reserve margin and accept an obligation to build.

"While the choice of who builds should be met through a least-cost, competitive bidding process, there must be a builder of last resort ready to shoulder the responsibility if merchant plants are very expensive or not built at all," Cooper said.

Meanwhile, an amendment by Sen. Dianne Feinstein (D-CA), to add transparency to the market for derivatives based on energy and metal commodities, was debated but not voted on before the Senate recessed for the Easter break.

The amendment, which is supported by CFA, U.S. Public Interest Research Group, Consumers Union, and the Derivatives Study Center, would put in place registration and reporting requirements for these derivatives, create capital requirements for unregulated derivatives dealers such as Enron and for all energy and metal derivatives transactions, and impose stricter prohibitions on fraudulent derivatives trading.

"The passage of this amendment into law will provide safety and soundness standards and finally begin to make these markets transparent," the groups wrote in March letter to members of the Senate.

"Congress has been holding hearings on issues related to Enron for months," Plunkett said. "It is time to act."

## On the Web

[www.consumerfed.org/enron\\_auditor\\_rpt.pdf](http://www.consumerfed.org/enron_auditor_rpt.pdf)

[www.consumerfed.org/enron\\_auditor\\_pr.pdf](http://www.consumerfed.org/enron_auditor_pr.pdf)

[www.consumerfed.org/hftest.pdf](http://www.consumerfed.org/hftest.pdf)

[www.consumersunion.org/finance/securdc202.htm](http://www.consumersunion.org/finance/securdc202.htm)

[www.enronwatchdog.org](http://www.enronwatchdog.org)

# Tax Loans Skim Millions from Working Poor

As this year's tax season kicked into high gear, CFA and the National Consumer Law Center issued a report warning of the exorbitantly high costs associated with tax refund loans.

Using names such as SuperFast Cash, Instant Money, and Fast Cash Refunds, tax refund anticipation loans (RALs) are short-term loans secured by the consumer's expected refund.

Tax preparers charge from \$29 to \$89 for the loans, which typically last about ten days, according to the report. That results in an annual interest rate of 67 to 774 percent.

"Refund anticipation loans are extremely expensive, charging rates that are comparable to payday loans, rent to own, car title pawns, and other forms of fringe credit," said CFA Director of Consumer Protection Jean Ann Fox.

"Cash-strapped consumers will pay about \$800 million in RAL finance charges alone to borrow their own money," she said.

About 11 million consumers get RALs each year, according to the report. The loans are repaid when the consumer's refund is received in a temporary bank account set up by the lender.

Unfortunately, consumers often do not realize that RALs are loans, Fox said, and that they are obligated to repay them even if tax refunds are disallowed or are less than expected.

## Earned Income Tax Credit Benefits Siphoned Off

The report focuses in particular on the impact of RALs on the working poor who qualify for the largest federal anti-poverty program, the Earned Income Tax Credit.

EITC benefits are delivered as a lump sum through the tax refund system. About \$30 billion was provided to 18.4 million low-income taxpayers through the pro-

gram last year.

Approximately 40 percent of taxpayers who get refund anticipation loans are EITC recipients, the report reveals. One reason, according to the report, is the scarcity of free tax preparation services. Working poor who cannot afford to pay tax preparation fees upfront may rely on the loans to pay for the tax preparation fees.

CFA and NCLC estimate that tax refund loans siphon off about \$324 million in loan fees and an additional \$670 million in tax preparation fees, electronic filing fees, and check cashing fees every year from EITC recipients.

As a result, \$994 million in benefits is drained from the Earned Income Tax Credit program. The total bill for the typical taxpayer is \$267, according to the report.

"The EITC lifts almost five million people, over half of them children, out of poverty," said NCLC Managing Attorney Margot Saunders. "EITC recipients need every penny of those benefits to build assets, pay necessary bills, and make ends meet in this economy."

"Taxpayer benefits for the working poor

## Terror Insurance, Continued from Page 4

that "if any federal back-up for this very wealthy industry is required, it should be a loan program modeled after the House bill, not a give away program that does not require assistance to be paid back."

In his testimony, Hunter outlined several steps Congress should take "to provide incentives to encourage fast developing private alternatives to the over-priced insurance of today's market," including:

- expanding the Liability Risk Retention Act (which allows small and mid-sized firms to pool their risk) to cover property insurance;
- determining whether there are any tax disincentives for the development of captive insurance or self-insurance mechanisms; and
- developing proposals to encourage the securitization of risk.

Finally, should Congress pass legislation, that legislation should roll back rates to reflect the reduced level of insurer risk that would occur if federal back-up is provided, CFA noted.

## State Action Advocated

The report also called on states to:

- reject terror exclusions for personal lines of coverage, such as homeowner and automobile insurance, which are not at risk of major terrorism losses;
- reject exclusions for commercial lines for small and mid-sized companies that are not at risk of high terrorism losses;
- require the cost of terror insurance coverage as a line item on the bill to discourage insurers from jacking up costs for coverage unrelated to terrorism;
- review pricing in the marketplace to prevent price gouging; and
- reject the model commercial lines deregulation bill recently adopted by the National Association of Insurance Commissioners.

"With the sort of gouging that is occurring in the market even for large risks, now is not the time to be deregulating commercial insurance regulation," Hunter said.

belong in consumers' pockets, not in the coffers of tax preparation firms and their partner banks," Fox added. "Holes in the consumer protection safety net permit usurious lending, deceptive marketing of loans, and unfair collection practices."

## Reforms Advocated

CFA and NCLC recommend that the loans be banned outright. Short of that, they should be subject to state usury and small loan interest rate laws, they argued.

"Tax preparation services should not be permitted to evade state consumer protections by partnering with national banks to make triple digit interest loans," Fox said.

The groups also recommend that the federally funded First Accounts pilot projects be targeted at working low-income consumers eligible for the EITC. The accounts are designed to provide electronic bank accounts to unbanked consumers who do not receive

ongoing federal benefits.

"The Treasury should encourage banks to allow Electronic Transaction Accounts for federal benefits recipients to receive tax refunds so that consumers can get refunds quickly without borrowing," Saunders said.

Citing a long history of deceptive advertising complaints about the loans, CFA and NCLC called on the IRS: to enforce its advertising rules for refund anticipation loans by revoking the electronic filing privileges of commercial tax preparation companies that violate the rules, and to refer bank partners of offending tax preparers to the Office of the Comptroller of the Currency or other appropriate agency for enforcement.

"The working poor need help from free tax preparation services and protection from deceptive lenders in order to get back all of their tax refunds and EITC benefits," Fox concluded.

## On the Web

[www.consumerfed.org/taxpreparers.PDF](http://www.consumerfed.org/taxpreparers.PDF)

[www.consumerfed.org/ral\\_cfa\\_nclc\\_pressrelease013002.pdf](http://www.consumerfed.org/ral_cfa_nclc_pressrelease013002.pdf)

## News Briefs

### Fise Retires from CFA

After 18 years with the organization, Mary Ellen Fise retired in February as general counsel of CFA.

In announcing Fise's retirement, CFA Executive Director Stephen Brobeck praised her for her "exemplary service and enormous contributions to the consumer movement and to CFA."

Fise has headed up CFA's advocacy on product safety and indoor air quality issues. In addition, she has mentored other staffers working on projects in these areas, including the cooperative agreement with the Environmental Protection Agency on indoor air quality and radon, the gun safety project, and the SafeChild website.

"Mary Ellen's contributions on product safety, standard setting, legal issues, project development and management, staff mentoring, and many other areas have been enormous," Brobeck said. "We will miss her greatly both professionally and personally."

### Radon Website Launched

In March, the Consumer Federation of America Foundation launched a new website for consumers who have tested for radon in their homes and found elevated levels.

Developed as part of CFA's cooperative agreement with the Environmental Protection Agency, the website provides general facts about radon, outlines specific steps to reduce radon, and provides information on locating a certified contractor to perform the work. It also links to sites with additional information.

The website is located at [www.radonfixit.org](http://www.radonfixit.org). Information is also available from the radon fix-it phone line, available 24 hours a day, 7 days a week at 1-800-644-6999.

"An estimated one in 15 homes in the U.S. has elevated radon levels, and 22,000 lung cancer deaths each year are attributable to radon," said CFA Director of Administration Betty Leppin. "Radonfixit.org is a new tool for consumers who want straightforward advice and information about reducing radon in their homes."

### SafeChild Website Wins Awards

The SafeChild website operated by the CFA Foundation has recently received two awards.

In February, [www.safechild.net](http://www.safechild.net) was announced as a 2002-2003 Golden Web Award Winner. The award is presented by the International Association of Web Masters and Designers in recognition of design and content originality and excellence.

In March, the Health Information Resource Center recognized [www.safechild.net](http://www.safechild.net) as the fall recipient of the gold medal for best health-related website for consumers and professionals.

"We are honored to be recognized by these awards," said CFA Project Manager Susan Winn. "We look forward to continuing to offer the most comprehensive child safety site on the Internet."

## CFAnews

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## Need for Terror Insurance Legislation Questioned

As Congress returned for the 2002 session, terrorism insurance legislation that dominated the congressional agenda late in the last session seemed to have been put on a back burner.

That is appropriate, CFA Insurance Director J. Robert Hunter told a House Financial Services subcommittee in February testimony. The testimony presented the findings of a CFA report, released in late January, which found that the failure of Congress to enact a terrorism insurance back-up has caused far fewer problems than anticipated.

Evidence for this conclusion includes lower than predicted World Trade Center losses, a surge of new capital into the industry, continued lending to businesses that have no terror coverage, and insurance consumers who are adapting to changing market conditions.

Of particular note, according to the report, are dramatically lower losses from the World Trade Center attack than insurers predicted. Whereas earlier estimates ranged as high as \$70 billion, the New York State Insurance Department now puts losses from the attack at \$35 billion, or \$23 billion after taxes.

"If the hit to the insurance industry's bottom line is less than expected, it stands to reason that the impact on business and consumers won't be as severe either," Hunter said.

He estimated that insurance industry losses will be 7.2 percent of surplus cash.

"While this is the largest loss ever in dollars, the impact on the industry's bottom line is not much more than the 6.3 percent hit from Hurricane Andrew," he said.

### Industry's Capital Reserves Grow

In fact, the report found that the insurance industry is actually more strongly capitalized now than before September 11.

While the capital lost on September 11 was about \$23 billion after taxes, the new capital already booked by the industry since then, in anticipation of high profits from large price hikes, is over \$24 billion.

In addition, at least eight new reinsurance companies have been formed, and the average stock price for the seven largest insurers has increased by 2.6 percent since the closing stock price of September 10, representing an annual rate of increase of 7.8 percent.

"This is not to say there are no problems in the market," Hunter said. However, the biggest concerns, he said, "are high insurance rates and price gouging for businesses."

These price jumps are "part of a classic 'hard' insurance cycle," he said. "They have been sped up by the events of September 11, but not caused by them."

"The real insurance costs of the attacks to most businesses should be quite low," Hunter said. "Unfortunately, some insurers have taken advantage of this situation to extract a pound of flesh from their customers."

CFA estimates that average insurance rates rose by about 20 percent for small businesses

over the last year, about 30 percent for mid-sized businesses, and about 40 percent for large businesses.

But those averages hide very high jumps in prices for some specific businesses, particularly large, "target risks," such as skyscrapers.

Terrorism coverage for smaller commercial accounts has been excluded in most states if insured losses from a terrorist attack exceed \$25 million. However, the coverage can be bought back at a price that is manageable for most small businesses, the study found.

While some large businesses are having difficulty getting sufficient terrorism insurance in amounts similar to the levels of previous years, these larger firms have many alternatives to traditional terror insurance coverage. These include self insurance, layering small insurance contracts to replace one big one, setting up "captive" insurance companies, and purchasing "Act of God Bonds" and other similar securities.

CFA also found that, contrary to predictions by some insurers, banks are loaning money to businesses and projects without full insurance coverage.

"The disaster scenario that the economy would be hurt because banks wouldn't extend loans has not played out," Hunter said. "Federal bank regulators have not

expressed concern, because they haven't seen evidence that the availability of credit has been affected."

### Congress Urged To Go Slow

Last year, CFA supported the terrorism insurance approach contained in H.R. 3210, as it passed the House Financial Services Committee, which would have required insurers to repay any assistance they receive. However, CFA is now urging a go slow approach.

"If CFA's research tells us anything, it is that the insurance marketplace is changing rapidly," Hunter said. "We believe it is clear that the private sector is winning the battle with terrorism, and coverage can be made available through insurance and alternative mechanisms if the government does not get in the way of the very positive developments we have documented."

He urged Congress to require a continuing series of reports by the General Accounting Office (one study has been released) to determine if there is a problem requiring federal action. He also recommended additional hearings, not only to examine market conditions, but also on private alternatives to federal back-up.

Hunter reiterated CFA's earlier message,

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### On the Web

[www.consumerfed.org/disaster\\_terror\\_insurance\\_1\\_02reportdraft.pdf](http://www.consumerfed.org/disaster_terror_insurance_1_02reportdraft.pdf)  
[www.consumerfed.org/disaster\\_terror\\_insurance\\_1\\_02reportrelease.pdf](http://www.consumerfed.org/disaster_terror_insurance_1_02reportrelease.pdf)

## National Strategy Needed To Boost Financial Literacy

A national strategy is needed to advance financial literacy, particularly for the tens of millions of the least affluent and least educated, CFA Executive Director Stephen Brobeck said in February testimony before the Senate Banking Committee.

"Because these individuals lack financial resources and often are charged high prices, they cannot afford to make poor financial choices," Brobeck noted. But, because of their low general and financial literacy levels and because they are especially vulnerable to abusive seller practices, "they often have difficulty making smart financial decisions."

The expanded availability and aggressive marketing of credit, including predatory mortgages and payday loans, to low-and moderate-income households has also increased their vulnerability and, with it, their need for financial education, he said.

Brobeck outlined five principles for effective financial education:

- seek behavioral change, not just improved knowledge;
- include "attractive," useful knowledge that can be easily applied by consumers making financial decisions;
- address values as well as knowledge;
- provide opportunities to learn by doing as well as by studying; and
- develop a comprehensive plan for increasing the financial literacy of all Americans.

"While many worthwhile financial education programs exist, they are not well-coordinated, effectively reach only a small minority of the population, and do not reflect any broad, compelling vision," Brobeck said. "What is most needed is a comprehensive needs assessment and plan to guide and inspire financial educators and their supporters."

Federal leadership will be needed to bring this about, he said. He called on Congress and the administration to work together to develop, build support for, and implement a plan.

Education is needed a supplement to regulation, not as a replacement, Brobeck emphasized. While regulation is needed to proscribe socially destructive practices, increase market transparency, and enforce related rules, he said, education is needed "to ensure that consumers have the ability to make rational decisions in relatively dynamic markets filled with a broad array of complex products."

Ultimately, efforts to increase financial literacy benefit society as a whole, by making individual economic decisions, and the economy, more efficient and productive, he concluded.

### On the Web

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