Consumer Federation of America

Testimony of
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On Behalf of the Consumer Federation of America,
Consumers Union and the U.S. Public Interest Research Group

Before the Senate Committee on Banking, Housing and Urban Affairs

An Examination of the Gramm Leach Bliley Act Five Years After Its Passage

July 13, 2004

Mr. Chairman, Senator Sarbanes, and Members of the Committee, my name is Travis Plunkett and I am the legislative director of the Consumer Federation of America.[1] We appreciate the opportunity to offer our comments on the effect of the Gramm Leach Bliley Act on consumers. This testimony is also being delivered on behalf of two other national consumer organizations, Consumers Union[2] and the U.S. Public Interest Research Group[3].

In the decade-long debate that led to enactment of the Gramm Leach Bliley Act (GLBA) in 1999, Congress heard many promises from financial services industry representatives about how tearing down the barriers between banking, securities and insurance sectors would be a boon to consumers. Banks, securities firms and insurance companies would merge into financial services "supermarkets" that offer increased consumer access to new, innovative products at lower costs with improved privacy protections.

Five years later, this rhetoric has proven to be mostly hype. Mergers have occurred, but mostly within the banking industry, not across sectors. While some, primarily affluent consumers may benefit from larger multi-state ATM networks, from discounts offered for multiple account relationships or from sophisticated financial products offered by boutique units to high-balance customers, we have seen no evidence that GLBA has positively affected the mass of banking consumers. It hasn't slowed the continuing trend of rising bank fees, nor has it helped decrease the numbers of unbanked consumers. Indeed, rather than offering innovative, moderately priced products to middle income consumers, or to unbanked consumers to bring them into the financial mainstream, some banks are developing policies and services that deliver second class or downright predatory products at an extremely high cost.

The corporate scandals of the last few years have also exposed potentially significant safety and soundness risks in allowing banks to sell both credit and investment banking services with inadequate regulatory oversight. The exponential growth of Industrial Loan Companies, which were allowed to continue to exist under GLBA without facing the rigorous regulatory scrutiny required of bank holding companies, has also started to create concerns that this shadow banking system could put taxpayer-backed deposits at risk.

Finally, the privacy requirements Congress ended up enacting as part of GLBA are narrow and weak. They don't provide consumers with a meaningful right to stop the sharing of much financial information with third parties or <u>any</u> financial information with corporate affiliates. Congress also missed an opportunity to modernize the Community Reinvestment Act by placing reinvestment requirements on non-bank firms that are performing bank-like functions.

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[1] The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

[2] **Consumers Union** is the nonprofit publisher of Consumer Reports magazine. Consumers Union was created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

[3] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

Instead, under the "CRA sunshine" provision, it placed burdensome and poorly crafted reporting requirements on both banks and community organizations.

I. Financial Privacy

During the decade-long debate that led to enactment of GLBA, our organizations repeatedly raised concerns about an almost total lack of federal financial privacy protections for consumers. Unfortunately, this situation has not changed demonstrably since the enactment of GLBA. The financial privacy requirements that Congress imposed on financial institutions in exchange for eliminating the barriers between banks, insurers and securities firms are narrow and weak. These requirements put the burden on consumers to stop the sharing of only some of the information shared by financial institutions with third parties. Even worse, these requirements offer consumers no ability at all to stop the sharing of sensitive financial data among financial affiliates. Moreover, the privacy notices that financial institutions are required to use to inform consumers of these limited rights are virtually incomprehensible. As a result, they are widely ignored by consumers.

Under Title V of GLBA, financial institutions only have to give consumers the opportunity to say no to ("opt out" of) the sharing of their financial information with certain non-affiliated third parties selling non-financial products. However, sharing is allowed with other third parties that have joint marketing agreements with financial institutions to sell financial products. In other words, consumers have no control over the sharing of their confidential "experience and transaction" information if two separate parties enter joint marketing agreements, nor do consumers have any right to stop the sharing of information among affiliates of a financial institution. Some financial institutions have hundreds of affiliates. A few have thousands of affiliates.[4]

The implications on consumer privacy of GLBA's establishment of one-stop shopping financial supermarkets are very serious, as decisions about the type of and prices for services and products offered to a consumer from one financial entity might be determined by information provided in the past to an affiliate. The type of information that is collected and shared often includes: account balance, payment history, parties paid by financial transactions, all credit card usage, employment and demographic information.

By combining all of these data about a particular consumer, financial institutions are able to create customer profiles. Profiles may then be used to determine how much a consumer will pay for a product or service or whether or not the consumer will be offered the product in the first place. Because this information sharing occurs among affiliates of a financial institution, these profiles are created and used without subjecting the firm to the requirements of or allowing consumers the protections of the federal Fair Credit Reporting Act (15 USC 1681 et seq).

The widespread sharing and selling of personal financial information is also one of the reasons why consumers have become more vulnerable to identity theft in recent years. Many

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[4] See testimony before this committee of Vermont Assistant Attorney General Julie Brill for a detailed list of some institutions' affiliates. Senate Banking Committee, Hearing On Affiliate Sharing Practices and Their Relationship to the Fair Credit Reporting Act , 26 June 03 available at http://banking.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=46 .

financial institutions have hundreds of affiliates that they share their customers' financial information with, and sell that same information to other third parties like telemarketers and direct mail firms. The more this information is disbursed, the greater the likelihood it will fall into the wrong hands and be used for illicit purposes. In the Fall of 2003, a Bank of America employee in Santa Ana, California was sentenced to state prison for stealing identity and account information for over 740 Bank of America customers. Obviously, financial institutions cannot ensure that information is perfectly secure at all times. Therefore, it is imperative to at least give consumers the ability to do everything they can to protect themselves against this crime.

Perhaps even more importantly, these business practices represent a fundamental invasion of consumers' privacy. Most of us are very selective when it comes to disclosing private financial information to others. When banks and other financial institutions share or sell information about our account balances or spending habits without first getting our permission, they are violating our desire to keep this information private.

To make matters worse, the privacy notices required under GLBA are at best extremely confusing, if not altogether deceptive. These were intended to serve two purposes. First, they were supposed to provide consumers directions on how to exercise their limited rights. Second, they were intended to inform consumers of the financial institution's privacy policies. Unfortunately, because they are so confusing and hard to understand they fail on both counts.

A July 2001 readability analysis of 60 financial privacy notices by the Privacy Rights Clearinghouse found that they are written at a 3rd-4th year college reading level. This is significantly higher than the junior high school level that is recommended for materials written for the general public. While we have heard anecdotal evidence that some privacy notices are getting clearer, they are still a far cry from sufficient.

If consumers are unable to read and comprehend their notices, they will simply throw them away and not exercise their limited rights. *The Wall Street Journal* summed up this situation accurately:

> "(I)n crafting the new law, known as the Gramm-Leach-Bliley Act, the government failed to ensure a vital detail: The mailers have to be readable to do any good. Indeed, many recipients, unwilling or unable to plough through the jargon and marketing talk, have simply tossed them in the trash. This only plays into the hands of the companies: a non-response to the mailer gives them a green light to sell that person's data.[5]"

Our organizations argued in 1999 that financial institutions should get the affirmative consent of consumers before sharing information with any outside party whether an affiliate or a third party. Our position has not changed, and if Congress chooses to address this issue again, the standard should be opt-in for information sharing among both affiliates and 3rd parties.

A number of financial institutions have been very active in recent rulemaking proceedings to improve the privacy notices. While consumer groups are generally supportive of these efforts to make the notices clearer[6], the exercise is, to some extent, like rearranging deck

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[5] "Privacy Notice Offers Little Help", By Russell Gold, *Wall Street Journal*, May 31, 2002.

[6] For example, one widely-supported proposal would be to require that the highlights of the privacy notice be summarized in a statutory box with express terms, similar to the widely-used nutrition labels required by the Food

chairs on the Titanic. Better notices will only help consumers more clearly understand that their underlying right to protect their financial information is very limited. Privacy notices are not privacy rights.

II. Safety and Soundness Issues

A. The Industrial Loan Company Loophole is Dangerous to the Banking System and Taxpayers and Should be Eliminated

As part of GLBA, Congress eliminated the unitary thrift loophole. This sent a clear message that it was the intent of Congress to slam the door on the mixing of banking and commerce. Consumer groups applauded this measure as an important step in better protecting taxpayers and the safety and soundness of the nation's banking system. At the same time, the GLBA made it possible for the first time for securities and insurance firms to own banks, but only if they were subject to the rigorous safety and soundness oversight required in the Bank Holding Company Act (BHCA).

Unfortunately, Congress left a little-noticed exception to the BHCA for Industrial Loan Companies (ILCs) in place when it put GLBA on the books. Commercial firms, such as General Motors, own ILCs, as do huge financial firms like Merrill Lynch, American Express and Morgan Stanley. Moreover, ILCs are subject to much less rigorous oversight than that received by bank holding companies from the Federal Reserve Board. Not surprisingly, ILCs have grown exponentially in recent years and are now threatening to become a parallel banking system that will siphon commercial deposits from properly regulated bank holding companies. Even worse, these commercial and financial firms are now urging Congress to expand ILC powers, allowing them to offer business checking and to branch to all 50 states.

This trend has enormous negative implications for the safety and soundness of ILCs and thus for taxpayers, who, of course, support the deposit insurance system. Our organizations strongly urge the Committee to consider legislation that would plug the ILC loophole before it is too late, and to reject legislation that would broaden ILC powers, for the following reasons:

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

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and Drug Administration. However, consumer groups would oppose efforts to have that be the only information consumers receive—it would not be acceptable, for example, to have privacy rights details exclusively available in a second "layer" that only appears on the Internet.

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

2. Large financial firms should not be permitted to skirt the GLBA by establishing a parallel banking system that is not subject to the rigorous oversight required for real banks. This represents an enormous and unacceptable risk to taxpayers. If large financial firms were to place their commercial banks under ILC oversight rather than Federal Reserve oversight, this could rapidly increase the number of ILCs and dilute the number of large financial systems that are subject to the important safety and soundness rules that the current system requires. Securities firms that own ILCs have taken the lead in promoting the expansion of ILC powers. They have not been shy about stating that they want to expand ILC powers because they do not want to deal with the regulatory oversight they would face from the Federal Reserve if they purchased a bank, as allowed under the Gramm Leach Bliley Act. Instead, they prefer to set up a "shadow" banking system through ILCs. They want to be able to offer the same services and loans as commercial banks without the same regulatory oversight.

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

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

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

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

As ILCs grow larger, so does commercial involvement in banking. Under current law, without any expansion of ILC powers, commercial firms can charter ILCs in several states. Under the Riegle-Neal Act's "opt in" provision for reciprocal state agreements (that allows banks chartered in each state to compete in all of them), 17 states already allow ILCs to branch into their territories. As stated above, firms such as General Motors, Pitney Bowes, BMW, Volkswagen and Volvo already own ILCs. States that have not restricted commercial ownership of ILCs, like Utah, are aggressively encouraging other commercial firms to purchase ILCs.

Instead of moving to close the ILC loophole, legislators in both the Senate and the House are actually seeking to expand ILC powers. H.R. 1375 would allow many existing and new ILCs to branch into all 50 states, whether these states approve or not, and to offer business checking services. (Business checking can only be provided by very small ILCs with less than $100 million in deposits.)

A Senate bill, S. 1967, would also allow industrial loan companies to offer interest bearing checking accounts to businesses after two years. Although there is a requirement that the Secretary of the Treasury and the Federal banking agencies issue joint regulations within two years after the date of enactment, the authority goes into effect after this period whether the joint regulations are issued or not. As it is highly unlikely that the FDIC and the Federal Reserve Board in particular would agree on joint regulations, our organizations view this bill as a straightforward expansion of the authorities of industrial loans companies.

We strongly urge the committee to stop both of these dangerous proposals in their tracks.

B. Banking/ Securities Conflicts of Interest

Among the restrictions in the Glass Steagall Act that GLBA eliminated were those that prohibited commercial banks from combining with investment banks to sell both credit and investment banking services. Consumer groups expressed many concerns through the 1990s that the banking/ securities combination in particular could allow financial investors access to insured deposits for high-risk lending schemes. This could, our groups predicted, subject consumers and shareholders to an increased potential for deception, leading to higher costs for consumers and taxpayers. Our organizations also expressed concern that complete elimination of the Glass

Steagall barriers also meant increased concentration, creating institutions of a size and complexity that would be impossible to regulate effectively.

Unfortunately, the corporate scandals of the last few years have provided widespread evidence of the kind of deception we were concerned about, as well as proof that financial regulators were not equipped to prevent these kinds of problems before they occurred, harming millions of small investors and – in some cases – putting deposits insured by taxpayers at risk. The involvement of investment banking firms like Citigroup in these scandals have provided a cautionary "case study" of the kinds of problems that can result when banks inappropriately "tie" decisions about lending and investment banking.

<u>Worldcom and Citigroup</u>

For example, let's examine Citigroup's involvement in the Worldcom scandal, as documented in great depth in an Emmy award-winning segment for the Public Broadcasting series *Frontline*.[7] Before Citibank merged with Solomon Smith Barney and Travelers Insurance to become CitiGroup, Worldcom had already become a very important investment banking client of Solomon Smith Barney. As a telecommunications firm whose business plan was to grow through mergers and acquisitions, WorldCom produced lucrative fees for the investment bankers chosen to handle these transactions. Solomon wanted that investment banking business, and Solomon's star technology analyst Jack Grubman was apparently willing to be a cheerleader for Worldcom's stock to keep this business. (As evidence that investment banking considerations influenced the research, Grubman justified his bonuses based on the investment banking business he was bringing into the firm.)

So, the first conflict that existed was that Grubman had a strong incentive to promote Worldcom's stock, and to continue to do so after its prospects had begun to deteriorate, in order to keep Worldcom as an investment banking client for Solomon. When Citibank CEO Sanford Weill consolidated Solomon, Travelers, and Citibank into a single entity, the conflicts just got bigger and more complex, with conflicts related to commercial loans added to the mix.

With Worldcom's stock having risen considerably, thanks in no small part to Grubman's cheerleading, Ebbers had a huge portion of his personal wealth in the form of Worldcom stock. He wanted cash, but he didn't want to sell the stock to get it, as cashing out his stock would have been looked on as a bad sign on Wall Street. In one case, the bank apparently came up with a plan to let Ebbers turn his stock into cash without the scrutiny that would accompany a sale. To accomplish that, the bank agreed to lend Ebbers the money, in the form of a $1 billion mortgage to a company he controlled. Once the property was purchased, Ebbers was able to turn around and sell a portion of the property for cash.

In another case, Citibank agreed to lend Ebbers money – in this case $43 million to buy a ranch – with the loan backed by 2.3 million shares of Worldcom stock. This transaction was questionable for a variety of reasons. First, stock is very risky collateral for a loan because of its inherent volatility. Telecom stock is especially risky because, as events later showed, telecom is a volatile business. It is, in our view, highly unlikely that Citibank would have entered into such

[7] <u>The Wall Street Fix</u>, Frontline, May 8, 2003.

a risky transaction had it not been seeking to curry favor with Ebbers and Worldcom. That also added a second dimension to the conflicts of interest – Citibank needed Worldcom's stock price to stay high in order to maintain adequate backing for its loans.

We know now that Worldcom's strategy of constant mergers served in part to hide its deteriorating financial condition. When the Sprint merger fell apart, however, Worldcom could no longer keep up the façade. There was a telecommunications capacity glut. Long distance prices were plummeting. Other Wall Street analysts were turning more negative on the company's prospects. WordCom's stock price began to drop precipitously.

The company desperately needed cash, and Citibank came through again. This time, it led a bank syndicate that sold investors $17 billion of Worldcom bonds. Worldcom turned around and used some of that money to pay off its debts, and Citibank used that payment to reduce its exposure to loans backed by Worldcom stock. This brings us to a third major conflict –of interest. Citibank's need to reduce its exposure to Worldcom loans appears to have been a factor in its investment bankers' willingness to approve a bond underwriting deal without appropriate due diligence on Worldcom's ability to repay the loans that those bonds represent and without adequate disclosure to investors of Worldcom's deteriorating financial condition.

Meanwhile, analyst Grubman was still doing his part, touting Worldcom's stock and calling it "an incredible bargain" at its newly reduced price. Given his access to top officers at Worldcom – he attended more than one board meeting and was listed as an adviser on the failed Sprint merger deal – it is hard to believe that Grubman could have been so oblivious to its deteriorating financial condition. At best, it seems logical to conclude that he ignored red flags because he had a strong incentive to ignore them.

There are three major lessons from this debacle for our discussion on GLBA today that are relevant. First, when major conflicts of interest exist and huge sums of money are at stake, abuses will occur. When Federal law has eliminated barriers to many of these potential conflicts, allowing them to flourish, it is naive to think that regulators can stop potential conflicts from becoming real conflicts through the erection of a few prohibitions.

Second, abuses are inevitable if businesses are allowed to create structures that are so big and complex that they require a major investment in regulatory oversight to prevent these abuses. However, once Congress allows these structures to be created, it had better be willing to provide the resources for regulatory oversight and to push regulatory agencies to be aggressive in enforcing the law. Third, investors will always be the ones left holding the bag when abuses occur. The system is not very good at restoring those losses once the damage is done.

Congress has in recent years given the Securities and Exchange Commission a much needed infusion of funding, though it is still not clear whether its funding matches its workload. Embarrassed by the New York Attorney General's Office, which has shown itself more than ready to step in and take action when it perceives there is an abuse that is not being addressed, the Commission appears to have made a new commitment to maintaining an aggressive enforcement program. Only time will tell whether the agency is up to the task. However, the

SEC is not alone in bearing responsibility, and a "solution" that focuses entirely on the SEC and ignores federal banking regulators will not solve the whole problem.

In the Citigroup/ Worldcom affair, the balance of power in the relationship seems to have tipped toward Worldcom. The picture that comes through is this: because Citigroup was desperate for Worldcom's investment banking business, it was willing not only to abandon all objectivity in its research, but also to overlook sound lending practices by offering loans to Worldcom and Ebbers that were not justified by Worldcom's underlying financial condition.

The conflicts that created this scandal are really the inverse of traditional "tying," when banks condition the availability or terms of loans or other credit products on the purchase of other products and services. In that situation, the balance of power tips toward the lender. There is some evidence that traditional tying may also be alive and well under GLBA.

A survey of corporate financial officers issued last year by the Association for Financial Professionals found that commercial banks frequently make access to credit contingent upon the purchase of other financial services.[8] Survey respondents indicated that they were concerned that if they did not award other business to their creditors, they would not receive credit in the future, or would receive less credit or pay a higher price.

While tying of this type is only a threat to the safety and soundness of the banking system if the bank offers loans at less than the market rate, or at otherwise more favorable terms to an unqualified borrower, it does represent a potential threat to shareholders, albeit one that is hard to quantify. For example, when a company is forced to pay more than it should for credit, that can affect the share price. Similarly, when a company selects investment bankers based not on which are the best qualified to do the deal or which are offering the most favorable terms to do the deal, but because of who is providing the company with credit services, this could drive up the cost of investment banking services. Those costs would also be absorbed by shareholders. We urge the Committee to investigate this problem further to examine what might be the ultimate costs and risks to shareholders.

Late last year, the GAO found a lack of documentation regarding tying the availability or price of credit to the purchase of debt underwriting services.[9] However, the GAO also stated that "the lack of documentary evidence might be due to the fact that negotiations over credit terms and conditions (during which a tying arrangement could be imposed) were generally conducted orally" and that "borrowers were reluctant to file formal complaints with banking regulators." GAO recommended that the Federal Reserve and the OCC take additional steps to enforce the anti-tying requirements in GLBA (in sections 106 and 23B) and look for indirect evidence to assess whether banks unlawfully tie products and services. We strongly agree with this recommendation.

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[8] Credit Access Survey: Linking Corporate Credit to the Awarding of Other Financial Services; Association for Financial Professionals, March 2003.
[9] Bank Tying: Additional Steps Needed to Ensure Effective Enforcement of Tying Prohibitions, General Accounting Office, October 2003.

III. Consumer Services Issues

A. Bank Fees Still a Problem

In the debates leading up to the enactment of GLBA, consumer advocates focused attention on bank services and fees and bank policies for retail bank products and services. While big banks are more likely to advertise "free checking" these days, a close examination of the Federal Reserve's annual report to Congress on bank fees will show that the cost of having and using a bank account has simply been shifted around.

Checking accounts are now viewed by banks with expanding branch locations as the entry point for new customers for cross-selling of other products and services. Banks are more likely now to offer accounts without monthly maintenance fees or a minimum balance to avoid fees (required to advertise as "free" checking by TISA), but make up the revenue on penalty fees. As a result, bank non-interest income and service fee income overall continues to rise. As noted by the Federal Reserve reports and US PIRG bank fee reports[10] over the years, banks continue to charge more fees, higher fees, and make it harder to avoid paying fees. In addition, both the Federal Reserve and the PIRG studies document that larger, multi-state institutions impose higher fees than local banks or credit unions.

Our groups are most concerned about growing fees that penalize consumers who have trouble making ends meet, including the insufficient funds fee, deposit item return fees and overdraft fees. According to the Federal Reserve, NSF fees averaged $21.73 in 2002, an increase over the prior year. Bank fee surveys find that NSF fees range up to $35 per item at some banks. Seventy five percent of banks now charge when items are deposited and returned for insufficient funds, averaging $6.88 in 2002. On average, banks charged $21.83 in 2002 for overdraft transactions, up over 1 percent from the prior year.

B. A Continuing Problem: The Unbanked

Millions of American consumers continue to conduct their routine financial transactions outside mainstream banking, a situation that has not significantly improved since GLBA was enacted. Despite high level regulatory attention to the problem of "banking the unbanked," including the FDIC's Symposium held last November, modest First Accounts grants from Treasury over the last two years, and roll out of the Electronic Transaction Account program of Treasury to implement EFT'99 goals of enabling direct deposit of federal benefits, conservative estimates find that ten percent of American families still do not have a transaction account at a bank or credit union.

Consumers without bank accounts are more likely to be young, lower income, minorities, renters, and have less formal education, according to the Federal Reserve Survey of Consumer Finances and academic and regulatory agency studies. One in three low to moderate-income consumers in New York City and Los Angeles does not have a bank account. Twenty-two percent of low-income households (8.4 million families making less than $25,000 a year) do not have a bank account.

[10] For example, Big Banks, Bigger Fees 2001, U.S. Public Interest Research Group, November 2001.

The high cost of being unbanked includes paying fees to cash checks, buying money orders to pay bills, paying to wire funds to distant locations, and lacking a safe place to save money. The unbanked live paycheck to paycheck, without savings to meet emergencies, making them susceptible to high cost forms of credit, including rent to own, car title pawn, and secured credit cards. While retailers such as Walmart have entered the check cashing business, charging a flat rate $3 to cash a payroll or government check, banks increasingly charge non-customers fees to cash checks drawn on the bank.

<u>Second Class Financial Products for the Unbanked</u>

Instead of bringing unbanked consumers into the mainstream by designing fairly priced products and services that meet the needs of consumers, banks and others are developing policies and services that deliver subprime protections. For example, Key Bank is now offering a "checkless" checking service, Key Checkless Access, for a fee of 1.9% per deposit to have paychecks direct deposited into a KeyBank account accessed by an ATM card. (The account is being marketed to consumers blacklisted on ChexSystems for nonfraudulent account mismanagement in the past.) Instead of providing account management training through such programs as Get Checking (developed by the University of Wisconsin Extension Service) and a free or low cost direct deposit account that cannot be overdrawn, KeyBank is charging check cashing fees for a limited use bank account.

Payroll cards and other stored value cards are growing in use as a way to deliver money without providing real bank accounts to unbanked consumers. Instead of opening bank accounts in the employees' names, some employers and their banks provide ATM cards that permit employees to withdraw their pay electronically from a pooled account. As the OCC noted in an Advisory Letter issued in May, unsettled regulatory issues include whether FDIC deposit insurance is available to cardholders, whether Regulation E applies to payroll card systems, whether section 326 of the Patriot Act (verification of new customers) applies, and whether Regulation CC (Availability of Funds) applies. Non-bank involvement in payroll card programs raises the risk for both consumers and banks if the non-bank becomes insolvent.

Financial services are being increasingly delivered via stored value cards rather than through accounts open in the consumer's name. The explosive growth of stored value gift cards and delivery of tax refunds and refund anticipation loans through stored value cards is taking place without adequate federal consumer protections. While consumers have federal protections when they use credit cards and debit cards, there is no federal stored value card law and it is unclear what federal protections apply to stored value cards. Convergence of plastic is not being supported by upgrading of consumer protections.

Stored value cards do not provide a means of asset development or a way to build credit worthiness. It is regrettable that mainstream banks are choosing to serve the financial needs of low to moderate income, unbanked consumers through second-class financial products and services.

C. Not What Congress Had in Mind: Mainstream Banks Offer High-Cost Credit

GLBA was intended to modernize banking law and to permit banks to affiliate with other financial entities to offer a wide variety of mainstream products and services to benefit American consumers. As stated above, we see no evidence that the "synergies" that the proponents of the law promised have led to substantial benefits for consumers. While some, primarily affluent consumers may benefit from larger multi-state ATM networks, from discounts offered for multiple account relationships or from sophisticated financial products offered by boutique units to high-balance customers, we have seen no evidence that GLBA has slowed the continuing trend of rising bank fee income (e.g. from service fees on deposit accounts, from penalty fees on credit cards and from ATM surcharges) nor has it helped decrease the numbers of the unbanked.

Indeed, some banks have chosen to go beyond the scope of mainstream financial services contemplated in GLBA and now participate in the triple-digit-interest rate "fringe lending" market, or offer predatory products like "bounce protection" that are all-but-indistinguishable from many fringe lending products. Given the number of banks now offering these high-cost products, or – in some cases -- affiliating with lenders who do, it is legitimate to ask whether Congress was fooled by the promise of innovative, affordable financial services products, only to find that the new products that are really being promoted have an outrageously high price tag.

Payday Lending and GLBA

For example, a handful of banks have chosen to "rent" their bank powers to pawn shops and small loan companies to assist those non-bank companies to make small loans at costs that would violate state laws. Payday loans are small loans made to cash-strapped consumers, secured by a post-dated check or access to the borrower's bank account. Loans for up to $500 plus a finance charge of $15 to $30 per $100 borrowed are due in full on the borrower's next payday. Payday loans are made without regard for the borrower's ability to repay. The cost of payday loans averages 470 percent APR, far in excess of some state usury or small loan laws.

Under a "rent-a-charter" arrangement, the payday lender markets the loans, solicits borrowers, accepts applications, disburses loan proceeds, services and collects the loans. The bank generally takes only a small percentage of the loan revenues – often as little as 5% -- while it's so-called "agent" takes the vast majority of the revenues generated by the loan.

While GLBA provided for bank affiliation with other mainstream financial entities, we are certain that Congress never intended to empower banks to rent their interest rate exportation powers to third party entities to make predatory loans or to undercut state authority to enforce usury laws, small loan regulations, and, even state payday loan laws. That's not what the payday lending industry thinks though. The industry filed an amicus brief in the U. S. Court of Appeals for the Eleventh Circuit, claiming that Georgia's law violated Section 104 of GLBA, despite the fact that Section 104 is clearly intended to govern the relationship between state laws and the sale of insurance by financial institutions. The Court rejected the brief on grounds that it made arguments not included in the District Court case.

Ten state-chartered FDIC-supervised banks partner with pawn chains, check cashers, and payday lenders,[11] according to CFA's latest report, Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury. No federally-chartered financial institutions or state member banks partner with payday lenders, following regulatory action by the Comptroller of the Currency, Office of Thrift Supervision, and Federal Reserve. These regulators found that payday lending exposes federally-insured banks to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risk.

Eleven of the thirteen largest payday loan chains use bank partners in states with consumer protection laws that do not permit unregulated payday lending, such as Pennsylvania, Arkansas, New York, North Carolina, Michigan, and Texas. Georgia recently enacted a law strengthening enforcement tools to prevent usury and to prohibit rent-a-bank payday lending where the local storefront gets the majority of the money.

State banking officials and Attorneys General in several states have challenged the claims of payday lenders that banks' exportation powers extended to them and alleged that rent-a-bank arrangements are fraudulent tactics to cloak illegal loan terms. States from California to Maryland have enacted anti-broker clauses in an attempt to prevent local lenders from partnering with banks to evade state consumer protections. In court litigation to date, none of these state anti-broker laws have been overturned. Federal courts in New York, Florida, Maryland, Colorado, North Carolina and Georgia have denied bank/payday lender claims to total preemption of state law and have remanded payday loan cases to state court. Yet the FDIC continues to permit the banks it supervises to aid storefront lenders in evading state consumer protections.

As the committee reviews the Gramm-Leach-Bliley Act, we urge you to clarify that bank charters are not for rent and halt the misuse of bank charters by third party lenders to make loans under terms prohibited by states.

Bounce Loans

Bounce loans[12] are a high-cost new form of overdraft protection that some banks are using primarily to boost their fee revenue, not to assist consumers.[13] Bounce loans represent a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit. These plans offer short-term credit at triple-digit rates. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243%. If the consumer pays the overdraft bank in 14 days, which is probably more typical for a wage earner, the APR is 541%.

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[11] State-chartered, non-member banks currently partnering with payday lenders are County Bank of Rehoboth Beach, DE; First Bank of Delaware; BankWest, Inc., SD; First Fidelity Bank, SD: Community State Bank, SD; American Bank & Trust, SD: Bryant State Bank, SD: Reliabank Dakota, SD: Republic Bank & Trust, KY; and Venture Bank, WA.

[12] Bounce "protection" is a euphemism used by banks to describe this high-cost credit product.

[13] For more information on bounce credit, see Consumer Federation of America & National Consumer Law Center, *Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks* (2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.

Bounce loans also permit consumers to overdraw their accounts at the ATM, at Point of Sale terminals, and through pre-authorized electronic payments. For many banks, the available balance displayed on the ATM screen includes the overdraft amount, misleading consumers about the true balance in accounts. Bounce loan plans turn debit cards into credit cards without consumer consent or disclosure of the cost of borrowing the bank's money.

Over 1000 banks have implemented bounce protection plans. Although many of these banks are small community banks, several very large national banks and thrifts offer this product as well, including Washington Mutual Bank, Charter One, TCF of Minneapolis and Fifth Third of Cincinnati.

This arrangement is much more expensive than alternatives that most banks offer, such as overdraft lines of credit, linking the account to a credit card, and transfers from savings. When a consumer uses bounce credit, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit, even where that deposit is protected income, such as a welfare or Social Security check. Consumers who do not want such an expensive "courtesy" must explicitly opt out by contacting the bank. The fee is often the same amount charged for an NSF fee on a returned check, and in some cases the bank also charges an additional, per-day fee. The Office of Comptroller of Currency has recognized that bounce loans are credit as defined by TILA.[14] Some state regulators have reached the same conclusion.[15]

There is considerable confusion and misunderstanding among consumers about the rules and obligations of bounce loans. Consumers often do not understand the full cost of these loans, and they do not understand the recurring nature and exorbitant cost of the ongoing use of bounce loans. In most cases, consumers do not affirmatively agree to this coverage. Instead, the bank imposes coverage to a subset of account holders as a "courtesy" or additional service feature of their account. Consumers would benefit enormously from application of TILA's open-end credit disclosure rules to these expensive and deceptive products.

The Federal Reserve Board recently announced new, proposed rules to govern bounce loans, but chose to cover them under the Truth in Savings Act, Reg DD. That is a completely inadequate response to the real need consumers have for information about the exorbitant costs of these loan products. Congress should step in and require – at the least – that bounce loans be treated just as all other extensions of credit are treated under the federal Truth in Lending Act. This equivalent treatment would simply – and most importantly – require that creditors of bounce loans *inform* consumers about the true costs of this credit and give consumers the right to affirmatively choose this product.

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

[15] Indiana Department of Financial Institutions, Newsletter – Winter 2002 Edition (Nov. 2002), at 2, Clearinghouse No. (D/E: Fill in number); Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001 (in response to referral from the Administrator for the Colorado Uniform Consumer Credit Code).

Ultimately, the irresponsible actions of banks in offering bounce loans will lead to more unbanked consumers. Instead of discouraging overdrafts and encouraging sound financial management, these banks are now *encouraging* consumers to overdraw their accounts and use high-cost credit. By permitting overdrafts, not just through checks but ATMs and debit cards (where it was impossible or much harder to overdraft before), these banks are creating more ways to impose exorbitant fees and create financial hardship. These banks may ultimately drive consumers away from bank accounts, either through consumer disgust at high fees or involuntarily through the Chexsystem blacklist. Consumers who are reported in the Chexsystems database for alleged bounced check activity find it nearly impossible to open a new account.

IV. GLBA and the Community Reinvestment Act

The Community Reinvestment Act (CRA) for over twenty five years has been a major tool in bringing capital and better banking services to the nation's underserved urban and rural communities. Yet given the changes well underway in banking and mortgage lending CRA is in need of some updating.

Two trends pose perhaps the greatest challenge to CRA. First, the increasing consolidation among banks, increased competition in the financial services industry, and the advent of new technologies have combined to shift financial assets out of traditional banks covered by CRA and into non-bank financial services providers, such as insurance, consumer finance companies, and mutual funds. Moreover, the rise of non-bank mortgage lending companies and the secondary mortgage market have reduced the importance of depository institutions as a source of mortgage funding. Consequently, CRA-covered institutions today make less than 30 percent of home purchase loans, compared with more than 80 percent they made when the law was first enacted, which has limited CRA's effectiveness.

The second important trend is the emergence of alternative delivery systems for promoting banking products, such as the Internet and telephone banking, instead of traditional brick-and-mortar branching networks. The changing way in which banks offer products to consumers poses a challenge to CRA, which traditionally relied upon a place-based definition to determine a bank's compliance responsibilities.

Two key changes to CRA would help to modernize the law and keep pace with these trends. First, CRA should be broadened to encompass a larger share of non-bank financial service providers. This can be done by extending CRA-like requirements to non-bank firms that are performing bank-like functions. The second key adjustment to CRA would be to broaden the definition of community beyond those areas where banks have physical branches. The expanding use of new technologies means that a bank's community for CRA purposes can no longer serve as a reasonable proxy for the location of a bank's customer base anymore. The banking regulators have discussed making such adjustments via regulations but have yet to act on these proposals.

GLBA provided an important opportunity to "modernize" CRA by applying these types of requirements to non-bank mortgage companies, insurance firms, and other financial institutions that affiliate with CRA covered banking institutions. Unfortunately, this did not happen. We encourage the Committee to update CRA along the lines we discuss as part of future legislation.

While failing to update CRA, GLBA includes a CRA-related provision that is not particularly constructive. I am referring to the so-called "CRA Sunshine Requirements," as contained in Section 711 of the Act. The provision requires banks and community groups to report to federal regulators about certain "CRA agreements" made pursuant to or "in fulfillment of" CRA.

Over the years CRA agreements between banks and local community groups have been frequently used to resolve disputes about lending practices and to target special efforts and facilitate local community reinvestment partnerships. Often these "CRA agreements" are reached while bank expansion requests are pending before regulators, although in recent years more and more institutions have elected to use pending mergers to announce unilateral CRA pledges.

Whatever the merits of requiring the reporting and disclosure of such agreements this statutory provision has not proven terribly useful to anyone concerned with these issues.

For one thing, the CRA sunshine provision is not particularly well crafted, requiring some CRA agreements to be reported and but not others. For example, it does not require banks to report unilateral CRA pledges, which now have become the predominate form that these commitments take. At the same time, CRA sunshine continues to impose reporting burdens on those banks and their community group entering into the more traditional types of two-party agreements. This is an inequity that neither the statute nor its regulations address.

Further, the CRA sunshine requirements were premised on what appears to be a faulty assumption – that community groups are somehow using the CRA process to extort money from banks for themselves. In fact, a study by the National Community Reinvestment Coalition that reviewed CRA agreements filed with federal regulators found that only .3 percent of the total funding contained in these agreement to be devoted towards general operating support for the non-bank parties. The disclosures confirm that the vast majority of these funds are directed to legitimate lending activities. (*CRA Sunshine Reveals Benefits of Bank-Community Group Partnerships, National Community Reinvestment Coalition, 2002, at 3*).

We believe that the CRA sunshine provision has outlasted its usefulness, if indeed it truly ever had one. We favor, therefore, repeal. Should the requirement be maintained, however, we believe that it should be overhauled to reduce its inequities and to minimize the reporting burdens and inconvenience this reporting provision imposes on the affected parties.