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H.R. 2309: The Consumer Credit and Debt Protection Act

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Good afternoon, Chairman Rush, Ranking Member Radanovich, and members of the Subcommittee. Thank you for inviting me to testify on the Consumer Credit and Debt Protection Act (CCDPA), a bill to bring long-needed reform that would enable the Federal Trade Commission to be a more efficient and effective force for protecting American consumers, honest and ethical businesses, and the integrity of a well-functioning marketplace.

Too often in the recent past, discussions over consumer protection regulation have been portrayed as a zero-sum game, where consumer protections are assumed to be a drag on the market, and must come at the expense of business. But that is a false dichotomy. Businesses have a symbiotic relationship with their customers. In the end, the health of the business community – indeed, the health of the economy as a whole – depends upon the financial health of America's households. Practices which undermine the financial health of households in the long run undermine the health of the businesses that depend upon them. If, for a while, we forgot that the absence of common sense and balanced rules for the marketplace is just as bad for business as it is for consumers, the events of the last year and a half should be a forceful reminder.

This shared benefit has been at the basis of the FTC's dual mission from its earliest days. Though Congress did not add preventing consumer injury explicitly to the FTC Act until 1938,[4] the Commission understood that unfair methods of competition injure both competitors and consumers, so that "there is a direct link between consumer protection and the prevention of unfair competition."[5] Honest, efficient and ethical competitors benefit as much from sound ground rules that level their playing field as do consumers.

In this testimony, we first discuss why we support eliminating what is functionally discrimination in the law against the FTC in its rule-making authority,

compared to other agencies. *Section I.* We also support the Congressional guidance to the FTC to use the APA rule-making in the area of consumer credit and debt, which we recognize to be central to the health of the economy as a whole. We first put that priority into context, with a general picture of the financial health of the majority of America's households. *Section II.* Turning to the specific areas identified in the bill, *Section III* discusses the two areas that the bill would set as priorities for the FTC: *III-A* explains some of the critical and widespread problems which have infected the auto sales and finance market. *Section III-B* details some of the problems in the debt settlement industry which led the sponsors of the CCDPA to prioritize that industry. In *Section III-C,* we suggest, too, that the Commission review its existing credit-related rules, including the Credit Practices Rule, now a quarter of a century old, to evaluate whether they need to be updated to address the evolution of the consumer credit market place. Finally, in *Section IV*, we support giving concurrent enforcement authority to state attorneys general.

I. Magnuson-Moss Rule-Making: The FTC's Albatross

A. Magnuson-Moss: Hollow Authority

The Magnuson-Moss procedure that the FTC is required by law to use to define unfair or deceptive acts and practices by rule is a cumbersome and resource draining process.[6] It has been almost a quarter of a century since the Commission used that process, when it adopted the Credit Practices Rule,[7] and its experience with that rule suggests why it has not been used again.

As a young lawyer, with just 34 months of experience, I was one of the witnesses in field hearings conducted by a Federal Trade Commission hearing officer as part of that process. That hearing was in Chicago, in October, 1977, and it was already two years after the proposed rule was published, in 1975. Magnuson-Moss even prescribes special judicial review procedures, and by the time that rule-making process was exhausted, including industry's failed legal challenge to the rule, a full decade had passed.[8]

Now, with over 35 years of experience, including eight years of law enforcement experience in a state attorney general's office, I can easily understand why the Magnuson-Moss process is little more than window dressing. With limited resources to deploy over a vast array of issues and players – literally thousands of players – and faced with a rapidly evolving and growing marketplace, it is not a rational choice for an agency that also has law enforcement responsibilities to commit to that kind of a long march into a blind tunnel.

We therefore strongly support putting the FTC's unfair and deceptive acts and practices (UDAP) rule-making authority on a procedural par with other agencies. The Federal Reserve Board last year promulgated UDAP rules regarding subprime mortgages using the Administrative Procedures Act's notice-and-comment process.[9] More recently, the FRB, the Office of Thrift Supervision and the National Credit Union Administration promulgated UDAP rules regarding credit cards issued by entities under their respective jurisdictions (the overwhelming majority of cards in American wallets), again using the

APA process.[10] Yet the FTC, the agency with the broadest jurisdiction, the agency with almost a century of experience with applying these concepts to evolving markets, has been bound for a quarter of a century by a far more cumbersome, expensive, and unwieldy rule-making process than these other agencies.[11]

B. An Ounce of Prevention is Worth a Pound of Cure: Prophylactive vs. Retrospective Regulation

Regulation can be forward looking, or backward looking. By virtue of the Magnuson-Moss rule-making, the FTC has been locked into the backward looking mode for all practical purposes. One type of preventive regulation, rule-making, sets the market standards. Businesses have a benchmark for their conduct, and consumers are in a position to know what those minimum standards of conduct are. Some agencies, such as the bank supervisory agencies, have an additional preventative tool when they have authority to do routine, recurring monitoring and oversight of the entities under their control. When properly utilized, this routine oversight should enable such agencies to identify problems early and stop them before they grow and infect the market. As we have seen to our regret, it does not always work this way in practice, but at least the structure is in place, when those regulators have the will to use it.

By contrast, the law-enforcement model is backward looking. As crucial as it is, it has serious limitations. One is that it is virtually impossible to get ahead and stay ahead in a time of rapidly evolving markets. Only after a practice has gotten big enough to create a problem of sufficient magnitude that it cannot be dismissed as “an isolated incident” does the law enforcement model kick in. By then, significant harm as already occurred. Further, law enforcement is targeted at particular defendants, not entire industries. Investigation and litigation can be a very long process. And, while, over time, standards can evolve from a series of case-by-case determinations, the market may have moved on in the meantime, and those standards may no longer be relevant to current realities.[12] So, while law enforcement is crucial, it is not, alone, adequate.

With respect to the credit and debt marketplaces, the FTC has been functionally limited only to the retrospective law enforcement model. It has no routine monitoring oversight authority, as bank supervisory agencies do. As we discussed earlier, while it in theory has rule-making authority, as a practical matter, the practical impediments against using it are far too great.

C. The Exercise of FTC Rule-Making Does Not Pose a Threat to Honest Businesses and Will Not Inappropriately Restrict Credit Markets

The opposition to consumer protection proposals virtually always includes assertions that it will harm the businesses affected. When the proposal relates to credit, it is also asserted that it will impede access to credit, thus really hurting consumers, as well. And today, of course, there is an addendum to that argument: “…. not now, when credit is already constrained.”

The evidence shows that those concerns are not warranted. Not even now. In fact, the lesson of the last two years is that what truly constrains credit is a lack of confidence – a lack of confidence that even some of the biggest financial institutions in the country actually knew what they were doing, and a lack of confidence that anyone was minding the store. Sound consumer protections, we now know, are not a zero-sum game – they benefit everyone.

Even before the current crisis, the evidence was against the *sky is falling* opposition. Two of the older FTC credit-related rules have done much to make the market more fair and more honest, a boon both for competition and consumers. They have proven their worth to consumers, and similar dire predictions of harmful unintended consequences failed to materialize. The "preservation of claims and defenses rule", which assures that lenders and sellers cannot separate the seller's obligation to comply with the law and contract from the consumers' obligation on that contract, has been particularly important.[13] This rule has been a part of most retail installment sales contracts since 1975, including car loans, to assure that consumers did not lose claims and defenses they had against car dealers just because the dealer arranged financing with or sold the contract to a third-party lender. The Credit Practices rule, the 1985 rule that was 10-years in the making, was the subject of similar dire warnings. Yet the segment of the consumer credit market affected by these rules grew from $189.5 billion in 1975, to $475.25 billion in December, 1985 to $1.6 trillion in March, 2009.[14]

Further evidence of the positive benefits of sensible rules is available from empirical evaluations of state laws aimed at curbing predatory mortgage lending. Studies have found that there is a Gresham's Law operating in the credit marketplace – with "bad money driving out good money." Far from having adverse impacts, sound regulation curbed the abuses, tamping down the bad lending, and allowed more room for good lending to flourish.[15] In other words, what's good for consumers is good for fair competition.

<u>Recommendation:</u>

We support the CCDPA's proposal to give the FTC fair and functional rule-making authority and authorize the Commission to use the same process that the other agencies with UDAP authority over consumer financial practices can use.

II. The Context: Consumer Credit and the Household Balance Sheet

We hear much today about the need to get credit flowing again, to get consumers buying cars again, to stimulate demand to get the economy moving again. Yet one of the issues on your radar screen, Mr. Chairman, is the "rogue" debt settlement industry, and its astonishing growth is explained by the simple fact that American households are drowning in debt.[16] This record debt load amplifies in today's recession the "Paradox of Thrift" conundrum that is a feature of all economic downturns. On the one hand, recovery requires stimulated demand in the aggregate. On the other, American

households need to de-leverage: too many are too burdened by debt, and for now, their economic future is uncertain. In this context, "getting credit flowing again" must not mean simply re-inflating a debt bubble.

I noted earlier that consumer credit – that is, non-mortgage credit – grew from $189.5 billion in 1975 to $1.6 trillion now. Overall household debt, including home mortgage debt, ballooned from $734.3 billion in 1975 to $13.8 trillion in 2008.[17] The debt-to-disposable income ratio per household more than doubled from 1980 (60%) to 2007 (133%).[18] For the middle three quintiles – the literal middle class – that ratio was 141% in 2004.[19] According to a recent article in *the Economist*, the share of household and consumer debt in our country "went up from 100% of GDP on [sic] 1980 to 173% today, equivalent to around $6 trillion of extra borrowing…."[20]

It is simple, but most likely neither fair nor accurate, to chalk these astonishing figures up to people "living beyond their means," with an unchecked taste for McMansions and bling. To dig deeper, we need to have a better sense of what it takes to live within our means these days. Over the course of the last twenty-five to thirty years, the real-after tax income gains in the bottom four quintiles have ranged from 6% (bottom) to 30% (4th), while the top quintile saw an 80% change and the top 1% saw a 228% gain.[21] Or, to put it another way, the "bottom" 90% saw an average income growth of 83% from 1946 – 76, but only 10% growth from 1976-2007.[22]

Table 1: Cumulative Percent Growth – Average Household Income

	"Bottom" 90%	Top 1%
1946-1976	83%	20%
1976-2007	10%	232%

A recent study of IRS data looked at income gains between 2002 and 2006, which sheds some light on why the majority of American families feel worried about the economy: 75% of all income gains between 2002 and 2006 went to the top 1% of American households – those making more than $382,600 a year.[23] In the meantime, the median household income, adjusted for inflation, dropped nearly $1000 from 2000 to 2006.[24]

Meanwhile, the growth in many of the big-ticket items on the expense side of the household ledger sheet has not been so slow. For example, since 1982, energy costs have risen 108%, health costs 251%, and college costs an astonishing 439%.[25] And, of course, there's housing: between 2000 and 2005, real housing prices grew 22%, while median wages grew only 1.7%.[26]

Against this backdrop, the need to assure that new credit is sold transparently and fairly is clear. We do not need – indeed, we cannot afford -- a return to too much debt that was deceptively sold, and recklessly given , solely to maintain growth and volume, without regard to whether it was sustainable, or had value to the consumer.

III. Where To Begin: Providing the FTC with Priorities for Rule-Making

The current crisis has exposed foundational cracks in our financial sector. Like a house with years of neglected maintenance, there is much that needs to be done, and the question is where to start chipping away at the "to-do" list.

The two items given top priority in H.R. 2309 deserve top priority. Vehicles are one of the three most expensive purchases most of us make, along with our homes and educations, and there are serious, insidious and anti-competitive abuses in the vehicle financing market in need of attention. And the combination of over-leveraged households and an economic downturn brings out opportunists who look for prey, instead of customers. The climate is ripe for them, and the market is rife with them. We support putting debt settlement companies on this list. We suggest adding a third top-tier priority to the list – a review of the Credit Practices rule, now nearly 25 years old to update it to address today's market.

A. Car Trouble: Problems in the Auto Finance Market

H.R. 2309 highlights auto finance practices for review by the Commission, and directs it to consider adopting rules in three areas:

- restricting post-sale changes in financing terms, the so-called "yo-yo" deals;
- dealer mark-ups, the practice of bumping up the rate at which the buyer qualifies to give extra compensation to the dealer; and
- permitting a cooling-off period following the sale or receipt of final information concerning the terms, similar to that available for non-purchase mortgages on primary residences.

The two abuses listed clearly meet the standard for "unfairness." They cause substantial injury to consumers, without countervailing benefits to consumers or competition, and they are not reasonably avoidable by consumers. The cooling off period is a reasonable way to provide a market incentive for the vehicle retailers to deal fairly and transparently with their customers at the outset – and to discourage not only the two listed abuses, but others not specifically listed.

CRL recently conducted a study of four significant problem areas in vehicle sales and financing, including two which H.R. 2309 identifies for attention: post-sale changes in financing terms, and dealer mark-ups.[27] Our data permits us to offer the subcommittee some specific information about how these two practices impact consumers nationally.

1. Post-sale changes in financing terms

a. *MacArthur in the showroom: The "yo-yo", or "spot-delivery" – the deal that isn't*

It is not music to the ears of a car salesman to hear from a potential customer: "We're going to go home and think about it first," or "We're going to shop around some more." That's a way to lose a sale to a better deal down the street, or to a decision against making a purchase at all. Better to reel in the deal before the customer walks off the lot, even if the deal isn't really a deal – at least as far as the dealer is concerned. There is a commonly used technique to accomplish this in sales where the dealer is arranging the financing. As with so much dealer lingo, the descriptive short-hand for the practice speaks volumes about the technique. Variously called a "yo-yo" sale, a "gimme-back", a "MacArthur" deal ("I shall return"), or "spot delivery", the technique is to send the consumer home with the vehicle "on the spot," with the retail installment sales contract in hand that incorporates the financing terms for the purchase. There's a hitch, though: the dealer – who is arranging the financing with a third-party lender -- actually hasn't concluded the financing half of the deal with that outside creditor. (Most dealers offer seller-financing in name only. Instead, they function essentially like mortgage brokers, arranging financing with a third-party lender. The resulting retail installment sales contract integrates the terms of the sale of the vehicle and the financing terms into a single contractual obligation for the consumer.[28])

The buyer may – but frequently does not – know that the contract is not really a final contract.[29] In the yo-yo deal, the consumer is called back to the dealership later – sometimes days, sometimes weeks later – because "the financing fell through." These consumers then are told they must sign a new contract with different – and more costly -- financing terms, pay the car off in full, or return the car (sometimes with a usage fee of some sort). Unfortunately, in the interim, the dealer also may have sold the consumer's trade-in, making it impossible to simply unwind the deal back to the *status quo ante.* With or without the complication of the disappearing trade-in, the consumer by then is both psychologically invested, and often economically invested in the new car, having paid for new insurance coverage, for example.

A justification often given for yo-yos is the "Saturday night sale" – it is a way to get an eager consumer into the car when the potential financing partners are unavailable, or unexpected impediments to the agreed upon deal. But few consumers are so cavalier about their finances to knowingly say: "I'll buy this car now. You can tell me next week what it will cost." Further, the practice occurs in far too many situations for an unexpected failure in the approval process to explain its frequency. (After all, like mortgage brokers, the finance and insurance staff – the "F&I guys" – are supposed to be credit professionals. Credit reports are available almost instantaneously on line, and credit professionals have a good idea of what prevailing rates are generally for ranges of credit capacity, types of collateral, and down payments.) Sometimes it is clearly a bait-and-switch: send the consumer off with a 9% contract, sell the trade-in, then call them back in to sign a 21% deal, as I saw happen. Sometimes it may be to renegotiate to

increase compensation to the dealership in other ways – to get more profitable add-ons packed into the loan, or to get more compensation out of the rate. (*See* III-B, below.)

b. *The profile of a yo-yo customer: vulnerable*

The CRL survey, unfortunately, gives some weight to the notion that yo-yo sales have a bait and switch taint to them. Sadly, it adversely affects low and low-moderate income buyers, and buyers with lower credit scores. We found that, of those who used dealer-financing for their last vehicle purchase, 1 in 8 buyers with an income less than $40,000, and 1 in 4 with an income less than $25,000, reported experiencing a yo-yo deal.[30] While at first blush it might be argued that it is simply harder to find financing for lower income buyers, that seems overly simplistic. Assuming again that the credit professionals at the car dealers are familiar with underwriting standards and consequently with what should be an affordable credit sale, as they should be, then it is difficult to understand why there is such a distorted impact. But more to the point, those who report being "yo-yo'd" pay more than equally positioned buyers who were not, on average, five percentage points more. (See Appendix A).

We may find a plausible parallel in the dynamics of the mortgage market as we have come to understand them. Many consumers were pushed into loans with riskier features than was appropriate to their needs and circumstances, and higher prices than they qualified for, in order for the supply-side of the market to maintain sales volume *and* increase profitability.[31] In other words, a shaky deal was better than no deal, and a deal with more profitability was better than one with less. The empirical evidence is that even the so-called "risky" borrowers could perform on loans with standard features, properly underwritten.[32] It is plausible, perhaps even likely, that the same dynamic operates on an auto lot. A yo-yo car deal reduces the odds of those consumers walking away from a deal that is too expensive in the first place, and increases the odds for the sales staff and the dealership to meet the monthly sales and revenue goals.

Another finding from our study also lends credence to the fear that the yo-yo is too often part of a bait and switch. After controlling for credit risk, we found that consumers who had experienced a yo-yo received an average interest rate that was *five percentage points higher* than a comparable risk-consumer who hadn't been subjected to a yo-yo. Cars are important assets for households, especially since so few areas have good public transportation alternatives. Making a car loan more expensive than risk requires for those least able to afford the excess loss of income is more than troublesome, and putting them at higher risk of default – with all the subsequent consequences of potential repossession, lower credit scores, and higher costs subsequently – clearly brings this practice well within the scope of a practice that causes substantial consumer injury.

2. Dealer mark-ups: Reverse competition in dealer-arranged financing

a. *Yield-spread premiums in the finance and insurance (F&I) office*

Another auto financing practice to which H.R. 2309 directs the Commission's attention is the dealer mark-up of the interest rate on a car loan over what the buyer qualifies for. The practice imposes substantial extra costs on consumers, just as the analogous "yield-spread premium" does in the mortgage market. In the mortgage market, we know that perverse market incentives encouraged brokers to steer their clients toward more expensive loans than the borrower would qualify for, because the brokers could increase their own compensation by doing so.

As explained above, the dealer functions as an arranger, or loan broker, for its customers who do not bring their own cash or financing.[33] The dealer's F&I staff deals with the buyer, discuss the financing needs, take the information, and act as the intermediary with the credit providers. And just as the mortgage brokers do, they are typically given the leeway by those lenders to close the deal at a higher rate than the buyer qualifies for. The dealer gets to keep all or part of that higher rate – a "mark-up" or a "yield-spread premium." Some call it, more simply, a kickback. This creates a "reverse competition" dynamic, where the intermediary has an incentive to steer the consumer to a higher rate option.

While dealerships argue that these yield spreads are compensation for arranging the financing, that argument does not justify the practice nor the cost. There is simply no legitimate reason for a dealer to receive more compensation for putting a consumer into a 10% loan than for putting her into a 9% loan. The only purpose the yield-spread premium serves is to incent dealers to squeeze extra interest payments out of their unknowing consumers. The abusive nature of the practice is intensified because consumers don't know about it or about how much it costs. Yet it is not a practice that can be cured by disclosure, as testing by the Federal Reserve Board and other agencies has demonstrated with YSPs in the mortgage market. Indeed, the FRB originally proposed to address the issue through disclosure, then withdrew the proposal because testing showed disclosure does not work well.[34] Moreover, the hidden cost is too substantial for that argument to be justified.

b. *Dealer YSPs: the $20.8 billion surcharge*

We calculate that nationally, these dealer kick-backs cost consumers an estimated extra *$20.9* billion in 2007. Chairman Rush: your home state of Illinois ranked # 6, with the 2007 volume estimated to be over $882.5 million. Ranking Member Radanovich, your state ranks # 1, with Californians paying about 10% of that national surcharge, at an estimated $2.5 billion.[35]

The dealer YSPs add an average $647 to the cost of each vehicle – the rate bumped up an extra .6% for new cars, and 1.8% for used cars. Other data, looking at five major captive auto lenders, reported an average mark up of $989 per vehicle.[36] If

evaluated as compensation for a "service", that is a hefty price. Particularly so for a service that, after all, benefits the dealer as much as the consumer: the dealer wants to make the sale, and financing is what lets that happen. In 2007, finance and insurance sales staff in the dealership averaged about half an hour with a customer – less if the customer took a test drive. That would mean that the dealer would be getting a whopping $1,097 per hour for the F&I "service" of putting the consumer in a higher rate loan than she qualifies for.

It is not unreasonable for car buyers to assume that the rate they are offered is what they qualify for, based on their creditworthiness and the collateral. This is particularly true when the retail installment sales contract actually lists the seller/dealer as the creditor on the deal.[37] Our survey indicated that close to half of buyer-borrowers did not negotiate the *credit* price because they trusted the dealer to give them a good rate.[38] These buyer-borrowers paid a steep price for that trust: it works out to a 2% "trust tax" on the price of credit.

But not all borrowers pay the YSP, so in fact, those consumers who do pay a mark-up pay more than that average. And in yet another parallel to the mortgage market, there is evidence from other studies indicating that minorities were both more likely than whites to be charged a kickback, and that the amount of the kickbacks were larger than the kickbacks whites were charged. Some 54.6% of African American's were charged a kick-back, compared to 30.6% of whites, and the amount of kickbacks charged to African-Americans is about $427 greater.[39] As a result of fair lending litigation over the discriminatory aspect of these mark-ups, some third party lenders capped the amount of the mark-up they permit dealers to around 2-3%.[40] However, that still is a considerable additional cost, and even assuming it eliminates the racially differential impact, it just puts the practice into the category of being an equal opportunity abuse.

Highlighting this practice as one for the FTC to prioritize for its rule-making is a welcome signal from Congress that the price of credit should be based on creditworthiness, not on opportunism, especially opportunism that adversely affects those who can least afford the excess cost.

3. A cooling-off period is a reasonable and proven mechanism to deal with high-pressure, high-stakes markets

We support the recommendation that that the Commission consider a cancellation period following the sale or receipt of financial information concerning the terms. Cooling-off periods have long been the law for several other types of transactions where significant assets are at stake, or high-pressure sales tactics are prevalent. Over forty years ago, Congress recognized that putting the family home on the line in a non-purchase money mortgage was both a major risk for a family, and where high-pressure sales tactics were far too common: a cooling off period let the consumer review the terms, seek advice, and think about it outside the high-pressure sales atmosphere.[41] It cannot be seriously argued that the availability of that right over the last forty years unduly harmed refinance mortgage lenders or restricted the flow of mortgage credit.

The auto sales and finance arena is a high-stakes, high-pressure market. A cooling off period is a sound and proven approach that ultimately encourages fair, transparent and pro-competitive behavior. Dealers who know that they can't trap a customer into a one-way deal like the yo-yo, binding on the customer but not on the dealer-- will have an incentive to offer final and fair terms upfront. Dealers who know that the consumer has a cooling off period will have no incentive to engage in the myriad other high-pressure tactics. Here, too, the beneficiaries are not just the consumers, but the dealers who don't want to do business that way.

***Recommendations regarding auto sales and finance*:**

H.R. 2309 would charge the FTC to consider adopting rules that "limit"dealer mark-ups, and "restrict" post-sale changes in financing terms. We believe that yield-spread premiums and yo-yo deals meet the test for unfairness, and that the legislation should assure that the FTC is clearly empowered to declare them to be unfair practices.

- *Dealer yield-spread premiums should be deemed an unfair practice*.

We strongly support bringing the costly and unfair practices of post-sale changes in terms and dealer mark-ups to the top of the FTC's to-do list. They are costly to consumers, and are inherently anti-competitive. CRL and NCLC have recommended that dealer yield-spread premiums should simply be banned: there should be no incentive for a dealer to put its customers into a higher-cost loan than that for which they qualify.[42]

- *Yo-Yo Deals should be deemed an unfair practice.*

Similarly, one-way deals like the yo-yo do violence to concept of bargained for contracts. They, too, should be banned, and dealers should be prohibited from selling any trade-ins until there's a final deal, and should be required to return any down payment, and any other fees or taxes associated with the deal.[43] These direct approaches should supplement the cooling-off period, preventing these inherently unfair and deceptive acts in the first place.

B. Debt Settlement: The Business Model Is Inherently Harmful to Vulnerable Consumers

As we discussed earlier, many Americans are under a serious burden of debt. The decrease in the value of the major asset most families own, their homes, and the loss of jobs has exacerbated those difficulties. Keeping ahead of that debt by churning it, from one credit card transfer to another, or a debt consolidation mortgage refinance was only a short term solution in the first place, and the current crisis has shut that option off in any event.[44] Moreover, some families in financial trouble are continuing to use their credit cards to pay for essential purchases and are therefore attempting to stay current on their credit card loans but not their mortgage payments, a shift in behavior from past economic crises that will likely lead to further deterioration of their financial condition.[45]

It is unsurprising, then that consumer demand for debt reduction or debt management assistance has increased.[46] And, it is unsurprising, too, that some of those who step up to "help" are scammers. There are different debt management business models. As discussed below, the *credit counseling* model, though not without its current problems, can with proper protections and under certain circumstances benefit consumers. The *debt settlement* model, on the other hand, does not—because the model itself is inherently problematic.

In the last decade, the number of debt settlement companies operating nationwide has increased from very few to as many as two- to three- thousand. These are typically for-profit entities, unaffiliated with credit card companies. Sometimes calling themselves credit counselors, they promise to painlessly reduce consumers' credit card debt through a variety of expensive, harebrained and harmful schemes.

In March, the Texas attorney general sued the debt settlement firm that calls itself the largest in the country, Credit Solutions, on claims of "false, deceptive and misleading acts and practices."[47] Just last week, New York's Attorney General, calling the debt settlement industry a "rogue industry," issued subpoenas to 14 of these debt settlement companies to inquire into their fee structures and whether they are indeed offering the relief they advertise.[48]

These state actions are encouraging, but the industry remains very loosely regulated, and its abuses are flagrant and highly destructive.

1. <u>The *credit counseling* business model is different from the *debt settlement* model.</u>

Credit counseling was created in the mid-1960s by credit card companies that saw an opportunity to recover overdue debts, and in the beginning, most of the agencies were non-profit.[49] These agencies offered a feature debt reduction service, the debt management plan (DMP), in addition to financial and budget counseling and community education sessions.

Under a DMP, a consumer sends the credit counseling agency a lump sum, which the agency then distributes to the consumer's creditors. In return, the consumer is supposed to receive a break in the form of creditor agreements to waive fees and lower interest rates. Consumers also gain the convenience of making only one payment to the agency rather than having to deal with multiple creditors on their own.

The credit counseling industry has not been without its share of serious abuses. Over the years, as creditors reduced the percentage of debt collected they shared with the agencies, the agencies curtailed some free counseling services and raised consumer fees for DMPs. By the late 1990s, complaints about deceptive practices, improper advice, excessive fees and abuse of non-profit status had sharply increased.[50] In response, regulators, policymakers, and state attorneys general conducted widespread

investigations,[51] and some state lawmakers put new laws on the books to curb abusive practices.[52]

In the last decade, credit card companies had been reducing the concessions they are willing to give debtors participating in DMPs. The Consumer Federation of America (CFA) found that some major creditors actually *increased* the interest rate they charge in credit counseling, while others have kept these interest rates high for many consumers.[53] This trend calls into question the viability of the DMP as a useful tool to help consumers reduce their debt. In a hopeful sign, the National Foundation for Credit Counseling recently announced that major creditors had agreed to offer "hardship" DMPs with more significant interest rate reductions to some consumers in credit counseling.[54] CFA has actively supported efforts to eliminate regulatory obstacles that inhibit issuers from authorizing DMPs that significantly reduce the principal (not just the interest charges) that consumers owe[55] and to limit consumers' tax liability when such principal is reduced. Reduced principal DMPs could not only help many families in debt trouble stay solvent, but also create a legitimate, pro-consumer alternative to debt settlement scams, as we discuss in the next section.

With appropriate protections, then, the credit counseling business model is not harmful and can be helpful to some consumers. An initial phase of research directed by CFA and American Express found that credit counseling can be effective in helping consumers to improve their creditworthiness over time.[56] And consumer groups often advise consumers that a DMP could be helpful in reducing some unsecured debts, depending on whether the financial condition of the debtor is stable or deteriorating, and on the interest rate reduction offered by creditors reduce some unsecured debts. (For a more detailed discussion of credit counseling issues, *see* CFA's testimony before the U.S. Senate Committee on Science, Commerce and Transportation, February 26, 2009.)

2. The debt settlement business model is inherently problematic.

Debt settlement involves negotiating with creditors to reduce the principal amount the consumer owes and to pay this reduced amount over a fairly short period, usually in one or two lump sum payments. Unlike most credit counseling agencies, debt settlement and debt negotiation companies are usually for-profit businesses. Settlement services are different from credit counseling (or debt management) mainly because settlement companies do not send regular monthly payments to creditors. Instead, these agencies generally maintain a consumer's funds in separate accounts— or direct consumers to deposit savings in an account that they can observe but do not control— until the company believes it can settle the consumer's debts for less than the full amount owed. Typically, debtors can only afford to pay off their creditors sequentially, saving up enough money (after upfront fees are paid) to make an offer to one creditor, then saving again until there is enough to offer a second settlement, and so on.

Many companies have advised consumers to stop paying debts as a condition of participation in the program. Debtors pay a variety of fees for this service, including

enrollment fees, monthly maintenance fees and a settlement fee, which is usually a percentage of the forgiven amount of debt.

The Federal Trade Commission and, as mentioned earlier, attorneys general in several states have brought actions against a number of these agencies. Appendix B provides significant details about the range of deceptive, fraudulent, and harmful practices that these companies used that the FTC has uncovered, which can be summarized as follows:

- **Settlement firms often mislead consumers about the likelihood of a settlement.** Evidence from debt settlement investigations indicate that a large number of consumers never complete a debt settlement program. One North Carolina assistant attorney general estimates that 80 percent of consumers drop out of debt settlement plans within the first year.[57] A receivers' report on the National Consumers Council, a purported non-profit debt settlement organization that was shut down by the FTC in 2004, found that only 1.4 percent of NCC customers settled with all their creditors.[58] 43 percent of their clients cancelled the program after incurring fees of 64 percent of the amount remitted to NCC.[59]

- **Unlike credit counseling agencies, settlement firms cannot guarantee to consumers that the creditor will agree to a reduced payment if certain conditions are met.** In fact, some creditors insist that they won't negotiate with settlement firms at all,[60] or that they will initiate a collections action if they learn that a debt settlement company is negotiating on behalf of a consumer.

- **Settlement firms often mislead consumers about the effect of the settlement process on debt collection and their creditworthiness**. Withholding payment to settle multiple debts is a very long process. Meanwhile, additional fees and interest rates continue to build up, creditors continue to try to collect on unpaid debts, and consumers' creditworthiness continues to deteriorate.[61] Some firms still advise consumers not to pay debts, either implicitly or explicitly.[62] Others firms say they never tell consumers not to pay their debts but only accept clients who have already stopped paying. Moreover, many settlement firms have not followed through with promises that they will stop collection calls from creditors.[63] In fact, under the Fair Debt Collection Practices Act, consumers can only request that third party collection efforts stop—not collection attempts by a credit card company on its own behalf.

- **Settlement firms charge such high fees that consumers often don't end up saving much to make settlement offers, which is why so many drop out of settlement programs.** Debt settlement firms typically require consumers to pay fees of between 14 and 20 percent upfront[64] (and as high as 30 percent)[65] before they receive a settlement. It is often not made clear to consumers that a hefty portion of the payments they make in the first year will go to the firm, not to their reserve fund or creditors.[66] Many firms also charge monthly fees to maintain

accounts, as well as a "settlement fee" of between 15 and 30 percent of the amount of debt that has been forgiven.[67]

- **As a result of high fees, consumers targeted by debt settlement companies are generally the least likely to benefit.** Some firms will work only with insolvent consumers who are unemployed or those in a hardship situation.[68] Many have minimum debt requirements of $10,000 to $12,000.[69] Consumers facing serious hardship with very high debts are, of course, the least likely to be able to afford the hefty payments that are charged. Settlement firms also appear to make no distinction, as a good attorney would, between consumers in these hardship situations who are vulnerable to legal judgments to collect and those who are not.

- **It is unclear what professional services most debt settlement companies offer to assist debtors while they save money to pay for a settlement.** Serious negotiation with creditors cannot commence until a significant settlement amount is saved, which could take years once high fees are paid. A persistent complaint by consumers is that settlement companies do not contact creditors at all in some cases.

3. <u>The impact on consumers is devastating.</u>

These practices clearly meet the test for substantial injury; indeed, the combined impact on consumers of these practices can be devastating. To get a sense of the impact on the many indebted borrowers for whom the debt settlement business model does not work, CFA examined some of the thousands of debt settlement complaints that are on various consumer review web sites. Here are a few summaries of the stories we found (all from the past eight months), which are generally consistent with claims made by the FTC in its investigations (*see* Appendix B):

- One (anonymous) consumer was convinced by a debt settlement company that it had strong relationships with major creditors and that its services would be a good alternative to bankruptcy. After she signed up with the settlement company, she was instructed to stop making payments to creditors. She later found out that the extent of the settlement company's involvement amounted to sending "power of attorney" letters to the creditors. Without help from the company she hired, she is now facing at least two collections lawsuits alone.

- One woman was persuaded to stop paying her creditors and to start paying the debt settlement company over $800 a month with the promise that her creditors would stop their collections calls and that she could reach a good settlement on her credit card balance. The settlement company took the money, but no settlements ever took place, and creditors never stopped calling. After seven months of no progress with her accounts, she stopped paying the company's fees. Without being able to get a refund of the more than $5,000 she paid in fees, she is now saving money for a bankruptcy lawyer. After a legal firm later acquired her

accounts, she discovered that the original settlement company routinely dealt with other customers in the same way.

- After hearing nothing from his debt settlement company for several months, Chris from Maryland attempted to respond personally to a credit card collections letter. The debt settlement company later scolded and threatened him because he contacted the creditor directly. He realized that the company was not keeping up its end of the bargain, and he decided that the $300 per month he was paying in fees was not money well spent. He has tried to sever his ties with the settlement company, but they continue to ignore his requests.

- "T" from Arizona regularly saw television advertisements for a particular debt settlement company and thought it appeared legitimate. He called the company and was promised that his payments would be only $300 a month. The company collected his personal financial information and instructed him to stop paying his creditors. After four months and over $1,500 in fees being automatically drawn from his bank account, the consumer found out that no creditors had been paid. He eventually had to put a "stop payment" order on his bank account to prevent the settlement company from automatically withdrawing what they pleased. The consumer is now stuck with a damaged credit report, excessive fees, and no debt settlements.

- Frank from New York was directly contacted by a debt settlement company after visiting the company website. After a promise that the company would settle his debts, he decided to accept the $250 per month fee. Nearly a year later, with no progress in debt settlements, he stopped hearing from them. After many unanswered calls and emails, he finally received a response from the company that he would get a partial refund. Since then the company has ignored his efforts to receive the refund and his debts remain unsettled.

Creditors obviously must share some responsibility for the growth of the debt settlement industry. For one thing, some credit card issuers are knowingly doing business with these firms. For another, there clearly is consumer demand for a <u>legitimate</u> debt reduction approach that offers more relief than traditional credit counseling but is not as far reaching as bankruptcy.

Ultimately, it appears clear that the business model for debt settlement is structurally flawed. The essential promise made by debt settlement firms to the public, that they can settle most debts for significantly less than what is owed, is often fraudulent. While there is general consensus that credit counseling, if done well, can provide significant benefits for some financially distressed consumers, no such consensus exists for debt settlement. Debt settlement firms should have to prove that, in the face of significant evidence to the contrary, their business model can and does actually help more than a few financially distressed consumers.

***Recommendations regarding debt settlement*:**

- *Congress should enact legislation mandating that the FTC issue a directed rulemaking on debt settlement and including minimum baseline standards.*

To date, debt settlement has been regulated primarily at the state level. Seven states have banned debt settlement.[70] Four more have adopted limited restrictions on the practice proposed by the National Conference of Commissioners on Uniform State Laws.[71] A number of other states have restrictions on debt management or adjustment that do not explicitly pertain to the practice of for-profit debt settlement, but cover it. States can also deploy laws regarding credit repair, the unauthorized practice of law, and unfair and deceptive practices (UDAP) against selected debt settlement practices.[72]

However, the growing prevalence of debt settlement companies, despite these state efforts, is clear indication that further action—a federal minimum standard—is needed. Congress should enact a federal law setting a strong minimum standard based on the best state laws directed specifically at debt settlement. The law should direct the FTC to implement rules and regulations necessary to effectuate its purpose and give the FTC enforcement authority. The FTC has used the FTC Act well to pursue settlement firms that have used unfair and deceptive practices and would be greatly aided by directed rulemaking authority.

At the very least, the minimum legislated standards should:

- *Require debt settlement firms to inform consumers upfront whether or not creditors will participate in the plan;*
- *Prohibit debt settlement firms from collecting any fees from consumers until debts are settled, except for a small enrollment fee;*
- *Prohibit firms from misrepresenting the impact of the settlement process on the creditworthiness of consumers;*
- *Place a cap on back-end settlement fees, based on the settlement services actually rendered rather than the amount of debt that was forgiven;*
- *Require that any debt serviced by a settlement firm be settled within 12 months.*
- *Limit agencies allowed to engage in debt settlement practices to non-profits.*

C. The FTC Should Also Give Priority to a Review of the Credit Practices Rule

We would like to take this opportunity to highlight another important issue that should be a high priority for the Commission. The Credit Practices rule, with its laborious birth, (see Section I) was worth the ten-year wait for consumers. Before the rule, it was standard practice for consumer credit contracts to include confession of judgment clauses and wage assignments, which subjected consumers to legal judgments or intercepted wages without due process and the safeguards of an opportunity to present defenses or counterclaims.[73] Creditors would routinely take non-purchase money

security interests in household goods worth little to the creditor, except for the collection value of a threat to “clean out their house.” (Indeed, my first client all those years ago was an elderly widow who came to us prompted by just such a threat. The list of items taken as security for her deceased husband’s small loan included everything, right down to “two grey washtubs.”) The credit practice rule changed all that, and contrary to the dire predictions of the credit providers, the sky did not fall.

In today’s market, there is a modern day equivalent of these now banned practices – taking a personal check or equivalent electronic access to a bank account and holding it as security for a short term small loan. Some short-term, small loan lenders require that the borrower provide them either a personal check made out for the amount of the loan plus the finance charge or grant authorization for the lender to electronically debit the borrower’s bank account The check or debit authorization is evidence of indebtedness, collateral for the loan, and a payment mechanism. The lender holds this check for the short period the loan is scheduled to be outstanding.[74] At the end of the short term, the consumer either brings in cash to pay the loan and reclaim the check, renew or roll-over the loan in some fashion, or the lender may use the check or electronic access to tap the deposit account.

There are many issues about this kind of lending: Congress has banned it for the military, and some states ban it, as well. But debates on those issues are for another day. Today we simply want to highlight a single feather – the check hold. This mechanism serves almost functions almost identical to the practices banned or limited in the Credit Practices rule. Given the prevalence of direct deposit paychecks, the direct access to the bank account that the check gives the creditor serves the same function as the wage assignment. For any other unsecured creditor to tap the bank account, it would have to go to court and obtain a judgment and garnishment order, making the check serve the same function as a confession of judgment clause. And, though the creditor knew the check was not backed by sufficient funds when written, (and hence is not a crime in most states), the consumers typically do not, which makes them vulnerable to *in terrorem* threats of criminal prosecution. We believe that the practice meets the FTC’s unfairness test just as do those parallels long banned under the Credit Practices Rule.

- *Substantial injury* results from basing loans on checks or debit access. Our legal system is not supposed to permit incarceration for failure to pay a debt. Yet some payday lenders threaten criminal sanctions when borrowers are unable to make good on the checks. Some state laws treat the unpaid loan as a civil bad check, triggering multiple damages, attorneys’ fees and court costs, while a few apply criminal sanctions for failure to make good on the check used to get the loan. By holding the borrower’s check, lenders get the ability to call the consumer’s bank to check “funds availability.” As soon as the bank tells the lender funds are available to cover the check, the lender goes to the bank to collect. Then other checks written by the borrower bounce.

- *Injury that the consumer cannot avoid* includes insufficient fund fees charged by both the lender and the borrower’s bank, possible loss of check writing

privileges, and civil and/or criminal penalties for failure to make good on the check used to get the loan. To avoid these expensive consequences of failure to repay, many consumers roll over the loan or borrow from a second lender to keep their checks afloat, incurring repeated exorbitant finance charges. Check holding is also unfair because it deprives the consumer of any opportunity to present defenses to the loan, and forecloses the consumer's option to repay in an affordable manner. When the lender deposits the check written to get the loan, the borrower's other outstanding checks for rent, utilities, and other payments will bounce, costing more fees and exposing the consumer to criminal enforcement of those checks.

- *Injury that is not outweighed by the benefits*. Check/debit holding is simply a collection mechanism. The loss rate for payday lenders is less than for credit cards. The *in terrorem* effect of check holding leads to injury that is not commensurate with the benefit of being able to borrow a few hundred dollars at triple-digit interest rates with balloon payment terms.

Congress has already prohibited this practice for our service men and women in the Military Lending Act due to its harmful impact on members of the military.[75] Civilians are harmed, as well, by this practice. We recommend that the FTC do a silver-anniversary review of the Credit Practices Rule to assure that it is adequate to cover contemporary equivalents of long-banned practices.

IV. State Attorneys General Should Be Given Concurrent Enforcement Authority

Finally, we fully support giving state attorneys general concurrent enforcement authority. We noted earlier that consumer credit has grown from $475 billion at the end of 1985 to $1.6 trillion this spring. Not all of that, of course, is in the FTC's bailiwick. Nonetheless, as the "default" federal regulatory agency, with jurisdiction over market players not specifically assigned elsewhere, it has a huge mandate. Add to that all its non-credit related responsibilities: advertising; marketing; privacy; data security; identity theft; internet issues like spyware, spam and phishing; telemarketing, direct mail and online fraud; health fraud; telecommunications. And that's just in the consumer protection bureau. Its resources are unlikely to ever be fully adequate to fully meet these needs.

Some state attorneys general have authority under their parallel state UDAP laws to take enforcement actions against entities subject to both jurisdictions, giving us enough experience to know that it is a viable model. But permitting this concurrent jurisdiction as a matter of federal law is important to assure that consumers in all states may benefit from having these extra cops on the beat.

In conclusion, we support the goals of H.R. 2309, and believe that it would bring much needed improvements to the marketplace, to the benefit of all.

[1] Ms. Keest is a Senior Policy Counsel at the Center for Responsible Lending (CRL), and was formerly Deputy Administrator of the Iowa Consumer Credit Code and an assistant attorney general in the office of the Iowa Attorney General. Delvin Davis and Joshua M. Frank of CRL conducted the study on auto financing practices discussed in this testimony. Rebecca Borné, of CRL, and Travis Plunkett and Jean Ann Fox of Consumer Federation of America wrote portions of this testimony or works upon which this testimony is based.

Center for Responsible Lending is a non-profit, non-partisan research and policy organization based in Durham, North Carolina, dedicated to promoting family wealth-building opportunities and eliminating abusive financial practices. It is an affiliate of Self-Help, a non-profit community develop financial institution that consists of a credit union and a non-profit loan fund. In total, Self-Help has provided over $5.6 billion of financing to 62,000 low-wealth families, small business and nonprofit organizations in North Carolina and across America.

[2] 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.

[3] The **National Consumer Law Center**, Inc. (NCLC) is a non-profit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes and regularly updates a series of sixteen practice treatises and annual supplements on consumer credit laws, including Truth In Lending, Cost of Credit, Consumer Banking and Payments Law, Foreclosures, and Consumer Bankruptcy Law and Practice, as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws.

[4] Wheeler-Lea Amendment, Publ. L. No. 75-447 § 3, (1938), amending current 15 U.S.C. §45(a).

[5] Michael M. Greenfield, *Consumer Law: A Guide for Those Who Represent Sellers, Lenders, and Consumers,* § 3.1, p. 58 (1995).

[6] 15 U.S.C. § 57a. The Act spells out a quasi-judicial procedure during which interested parties may give statements, present evidence, even *cross-exam* other witnesses. A hearing officer presides over these proceedings, and issues findings and conclusions to a presiding officer. The presiding officer cannot consult directly with interested parties without giving notice to other interested parties. The presiding officer then issues recommendations. The last rule issued using this procedure resulted in an entire book of the hearing officer's findings and conclusions, and, if memory serves, a second book of the presiding officer's recommendations.

[7] 16 C.F.R. § 444.

[8] 48 Fed. Reg. 7740 (March 1, 1984), *effective* March 1, 1985; appeal *American Financial Serv. Assoc. v. FTC*, 767 F.2d 957 (1985), *cert. den.* (1986).

[9] 73 Fed. Reg. 44522 (July 30, 2008). While these rules did come a bit late in the game to prevent the last meltdown, they do set a base-line of fair conduct that will, one hopes, prevent a resurgence of the same unregulated and highly damaging practices that brought on the crisis.

[10] 74 Fed. Reg. 5498 (January 29, 2009).

[11] The Magnuson-Moss rule-making procedure was adopted in 1975. Magnuson-Moss Warranty –FTC Improvement Act § 202(a), Pub. L. No. 93-637 (1975).

[12] The dynamic of these different kinds of regulation as applied to the subprime mortgage market is discussed in prior testimony relating to the FTC, *see* Hearing Before the Senate Committee on Commerce, Science and Transportation, Subc. on Interstate Commerce, Trade and Tourism, "*Improving Consumer Protections in Subprime Home Lending*," April 29, 2008 at 5-11 (Test. of Kathleen Keest, Center for Responsible Lending), *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/keesttestimony-senate-commerce.pdf

[13] 16 C.F.R. § 433 (promulgated 1975).

[14] Federal Reserve Statistical Release G.19, *Consumer Credit,* figures for non-revolving consumer credit. http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.html ("consumer credit" excludes mortgages, "non-revolving" excludes credit cards.)
The preservation of claims and defenses rule applies to closed-end loans financing the purchase of goods or services where the seller assigns the contract to a third party or arranges for the financing, which includes most dealer-arranged auto sales. *See generally* Kurt Eggert, Held Up In Due Course: Codification and the Victory of Form Over Intent In Negotiable Instrument Law, 35 Creighton L. Rev. 363, 428-430, (2002)(noting the absence of serious negative consequences on legit imate lenders). The credit practices rule is discussed in Section V, below.

[15] Wei Li and Keith S. Ernst, Do State Predatory Lending Laws Work? A Panel Analysis of Market Reforms, 18:2 Housing Policy Debate, p. 347 (2007).

[16] By one report, the industry grew from 300 to a 1000 companies in "just the past couple of years." "*Cuomo targets debt settling companies,*" NPR Marketplace, May 8, 2009, http://marketplace.publicradio.org/display/web/2009/05/08/pm_cuomo/.

[17] 1975 figure from Federal Reserve Board Flow of Funds Accounts Z.1, Table D.3 (June 5, 2008); 2008 figure from the March 12, 2009 release, http://www.federalreserve.gov/releases/z1/Current/z1r-2.pdf

[18] Dean Baker, *Dangerous Trends: The Growth of Debt in the U.S. Economy,* at 4, Fig. 1 (2004); Stephen Roach, *Comment: America's Inflated Asset Prices Must Fall,* Financial Times, January 8, 2008.

[19] Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and the Middle Class Squeeze,* p. 21, 24, Levy Economics Institute at Bard College & Dept. of Economics, NYU, Working Paper No. 502 (June 2007).

[20] The Economist: "Greed – and Fear: A special report on the future of finance, *Fixing Finance*," p. 20 (January 24, 2009).

[21] Arloc Sherman, *Income Inequality Hits Record Levels, New CBO Data Show,* Center on Budget and Policy Priorities, (December 14, 2007).

[22] Chye-Ching Huang and Chad Stone, *Average Income in 2006 Up $60,000 for Top 1 Percent of Households, Just $430 for Bottom 90 Percent,"* Fig. 2, Center for Budget Policy and Priorities, *updated* October 22, 2008, *available at* http://www.cbpp.org/3-27-08tax2.htm (based on the work of Thomas Piketty and Emmanuel Saez)

[23] Justin Fox *How the Next President Should Fix the Economy*, 37, 38 TIME (May 26, 2008).

[24] *Id.*

[25] Penelope Wang, *Is College Still Worth the Price,* http://money.cnn.com/2008/08/20/pf/college/college_price.moneymag/ (updated 4/13/09).

[26] *See* Testimony of Eric Stein Before the U.S. Senate Committee on Bank, Housing and Urban Affairs, *Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis*, p. 11, (Oct. 16, 2008).

[27] The first release focused on the impact on North Carolina consumers. *See* Delvin Davis and Joshua M. Frank, *Car Trouble: Predatory Auto Loans Burden North Carolina Consumers*, Center for Responsible Lending, (April, 2009), *available at* http://www.responsiblelending.org/other-consumer-loans/auto-financing/car-trouble-predatory-auto-loans-burden-north-carolina-consumers.html

[28] With dealer-arranged financing, the seller-dealer is commonly listed as the creditor on the retail installment sales contract. However, the third-party lender to whom the dealer has sent the application makes the decisions to approve or disapprove, and, if approved, the terms of the credit. A dealer may – or may not – shop the application to multiple lenders, with implications discussed in the next section. The retail installment sales contract, on is on its face a two-party consumer contract between the buyer-borrower and the dealer. That is one contract. But that contract is then "assigned" – often simultaneously, to the third party lender. Legally, these are separate transactions: the assignment is a second, independent commercial contract between the dealer and the creditor. *See, e.g.* Patterson v. Ford Motor Credit Co., 2000 WL 123943 (4th Cir. 2000) (purchase of installment sales contract by FMCC is part of separate transaction from underlying automobile sale; assignment of contract is wholly between dealer and indirect lender); Walker Mobile Homes Sales, Inc. v. Walker, 965 S.W.2d 271 (Mo App. WD. 1998)(retail installment sales contract was a contract between the buyer and seller; not between assignee and buyer). But the parties all treat it functionally as a two-stage single transaction. The disconnect between the legal posture and the functional understanding is how dealerships exploit the situation to make this a one-way, one-sided deal: the consumer is bound, but the dealer is not. For a more detailed description of the process and the legal ramifications, *see* National Consumer Law Center, *Automobile Fraud* , Ch. 3a (2008 Supplement).

[29] In some cases, the contract is completed in the same way as any other contract, with no hint that any terms are subject to change. In other cases, there may be a reference to its being subject to financing or other language that it is conditional. Depending upon state law, the conditional sale may or may not be legal. For example, in Iowa, the cumulative effect of the credit code and the retail installment sales act precludes taking a retail installment sales contract signed by the buyer until the terms are final, which arguably precludes a subsequent condition on the contract.

States have adopted a variety of approaches to limit the yo-yo practice. Citations are compiled in John W. Van Alst, *Fueling Fair Practices*, p. 13, note 22, National Consumer Law Center (2009), *see generally* National Consumer Law Center, *Automobile Fraud* , Ch. 3a (2008 Supplement).

[30] Appendix A includes a summary of the findings and an explanation of the methodology.

[31] *See, e.g.* Keith Ernst, Debbie Bocian, and Wei Li, *Steered Wrong: Brokers, Borrowers and Subprime Loans*, Center for Responsible Lending (April 8, 2008), *available at* http://www.responsiblelending.org/issues/mortgage/research/steered-wrong-brokers-borrowers-and-subprime-l-oans.html. *See also* Structured Finance in Focus, *The Subprime Decline – Putting it in Context*, p. 3, Moody's Investors Service (March 25, 2008) ("The subprime crisis is largely a product of increasingly aggressive mortgage loan underwriting standards adopted as competition to maintain origination volume intensified amid a cooling national housing market.")

[32] Lei Ding, Roberta G. Quercia, Wei Li, and Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, Center for Community Capital, Univ. of North Carolina & Center for Responsible Lending (Working Paper, Sept. 13, 2008).

[33] *See* III-A-1, text accompanying note 26. Some used-car dealerships, called "buy-here, pay-here" dealers, do act as both seller and creditors.

[34] 73 Fed. Reg. 44522, 44563-65 (July 30, 2008)

[35] *See* Appendix A, Fig.2 for complete list by state.

[36] Mark A. Cohen, Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Vanderbilt University (Dec 2006).

[37] As explained in note 26, though the seller-dealer is listed as the creditor on the contract, in fact it typically sends the credit application to one or more potential third- party lenders for approval or disapproval. The outside lender tells the dealer the terms upon which it would approve the deal, including the "par rate" or "buy rate" – that is the rate that the buyer qualifies for based on its credit qualifications and the collateral. The dealer mark-up, or yield spread premium is an upward bump to that "buy rate" from which the dealer receives extra compensation.

[38] *See* Appendix A. This too, is parallel to the mortgage market, where many borrowers believe that lenders are required to give them the best rate they qualify for.

[39] Mark A. Cohen, Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Vanderbilt University (Dec 2006). Figures are weighted averages using data from five major auto finance companies compiling 12.6 million records between 1993 and 2004.

[40] For example, the settlement agreement sets limits in this range for GMAC in *Coleman v. GMAC*, Para. 8.3, No. 3-98-0211 (M.D. Tenn, settlement agreement filed Feb. 10, 2004), *available at* http://www.consumerlaw.org/issues/cocounseling/content/GMACSettlementAgrmt.pdf

[41] Truth in Lending's unconditional 3-day cooling off period applies to non-purchase money homes secured by the consumer's primary dwelling. 15 U.S.C. § 1635. Home solicitation sales are also subject to a 3-day cooling off period under an existing FTC rule, 16 C.F.R. § 429, and analogous laws in all 50 states. Sales of timeshares, too, maybe subject to a cooling off period, *see, e.g.* Part 24 of Title 13 NYCRR.

[42] *See also* Van Alst, *Fueling Fair Practices*, at 14-15 (discussing other approaches, including the possibility of a flat fee for arranging credit, which would eliminate the possibility of discriminatory pricing. CFA has called for an end to unfair dealer markup while acknowledging that dealers should be able to receive some sort of fee).

[43] Several states have addressed yo-yo sales in a variety of ways. *See generally* John W. Van Alst, *Fueling Fair Practices*, National Consumer Law Center, (2009), *available at* http://www.consumerlaw.org/issues/auto/content/report-fuelingfairpractices0309.pdf

[44] Westrich, Tim and Weller, Christian E., "House of Cards, Consumers Turn to Credit Cards Amid the Mortgage Crisis, Delaying Inevitable Defaults," Center for American Progress, February 2008.

[45] Chu, Kathy, "More Americans Using Credit Cards to Stay Afloat," *USA Today*, February 28, 2008.

[46] "Look Out for That Lifeline, Debt-Settlement Firms are Doing a Booming Business—And Drawing the Attention of Prosecutors and Regulators," *BusinessWeek*, March 6, 2008.

[47] David Streitfeld, *An Inquiry Into Firms That Offer to Cut Debt* , N.Y. Times, May 7, 2009.

[48] *Id.* Mr. Andrew Cuomo said he issued subpoenas to the following firms: American Debt Foundation Inc., American Financial Service, Consumer Debt Solutions, Credit Answers L.L.C., Debt Remedy Solutions L.L.C., Debt Settlement America, Debt Settlement USA, Debtmerica Relief, DMB Financial L.L.C., Freedom Debt Relief, New Era Debt Solutions, New Horizons Debt Relief Inc., Preferred Financial Services Inc., U.S. Financial Management Inc. (operating as My Debt Negotiation) and Allegro Law.

[49] Housing counseling agencies, now central to seeking work outs for mortgages to avoid foreclosures, are yet a distinct species of credit counseling, and are not described in this testimony.

[50] Loonin, Deanne; Plunkett, Travis; "Credit Counseling in Crisis: The Impact on Consumers of Funding Cuts, Higher Fees and Aggressive New Market Entrants;" National Consumer Law Center and Consumer Federation of America; April 2003; http://www.consumerfed.org/pdfs/credit_counseling_report.pdf.

[51] "Profiteering in a Non-Profit Industry: Abusive Practices in Credit Counseling," Report Prepared by the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affars, United States Senate, April 13, 2005, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_reports&docid=f:sr055.pdf. By late 2006, the IRS had investigated 63 agencies that brought in more than half the revenue of the entire credit counseling industry for violating their non-profit status.http://www.irs.gov/charities/article/0,,id=156827,00.html. The IRS has since reported that it has "revoked, terminated or proposed revocation of over half of the organizations examined, representing 41 percent of revenue in the industry," http://www.irs.gov/charities/article/0,,id=156829,00.html.

[52] Some states used the Uniform Debt Management Services Act proposed in 2005 by the National Conference of Commissioners on Uniform State Laws as a model and others acted independently to adopt standards regarding business practices and fees.

[53] For example, when CFA surveyed interest rates in credit counseling in 1999 and 2003, Bank of America was a model for the rest of the industry, charging 0 percent APR for those in a DMP. Consumer Federation of America, "Large Banks Increase Charges To Americans In Credit Counseling, New Practices Will Hurt Consumers On The Brink Of Bankruptcy, July 28, 1999. National Consumer Law Center, Consumer Federation of America, "First-Ever Study of Credit Counseling Finds High Fees, Bad Advice and Other Abuses by New Breed of 'Non-Profit' Agencies," April 9, 2003; http://www.consumerfed.org/releases2.cfm?filename=040903ccreport.txt. Now, Bank of America has a range of interest rates from 1 percent all the way up to 16 percent. There is not a single major credit card issuer right now that charges less than 5 percent APR for all of its clients in DMPs. (JP Morgan Chase comes the closest, at 6 percent.) Capital One charges a 15.9 percent rate, unless the client enters counseling with a lower rate. Discover charges a range of rates that go as high as 15.9 percent as well. Consumer Federation of America, Testimony before the U.S. Senate Committee on Science, Commerce and Transportation, Feb. 26, 2009.

[54] Michelle Singletary, *As Recession Deepens, Even Credit Cards' Minimums Can Become a Burden*, Washington Post, Apr. 23, 2009.

[55] The OCC and other financial regulatory agencies rejected a request made by CFA and the Financial Services Roundtable on October 29, 2008 to permit a pilot project that would allow some credit counseling agencies to offer some consumers reduced principal DMPs over a period of up to 60 months. Current guidance requires that reduced principal "settlements" must generally be paid in full within three to six months. Multi-year, reduced principal payment plans are not allowed unless the issuer charges off the entire loan before offering the settlement.

[56] Staten, Michael E., Barron John M., "Evaluating the Effectiveness of Credit Counseling," May 31, 2006; http://www.consumerfed.org/pdfs/Credit_Counseling_Report061206.pdf. Consumers who were recommended for a DMP by agencies and chose to start payments had a significantly lower incidence of bankruptcy, as well as improved bankruptcy and delinquency risk scores, over the two years following counseling than did those who were recommended for a DMP and chose not to start.

[57] "Look Out for That Lifeline, Debt-Settlement Firms are Doing a Booming Business—And Drawing the Attention of Prosecutors and Regulators," *BusinessWeek*, March 6, 2008.

[58] Robb Evans and Associates LLC, "Report of the Temporary Receiver, May 3, 2004 – May 14, 2004, First report to the Court."

[59] *Id.*

[60] Robert Berner and Jessica Silver-Greenberg, "Look Out for That Lifeline, Debt-Settlement Firms are Doing a Booming Business—And Drawing the Attention of Prosecutors and Regulators," *BusinessWeek*, March 6, 2008.

[61] *Id.*

[62] *See*, *e.g.*, FTC Investigation of Edge Solutions, Inc. and Money Cares, Inc. aka The Debt Settlement Company and The Debt Elimination Center; Pay Help, Inc.; Miriam and Robert Lovinger, Press release, Aug. 5, 2008 at: www.ftc.gov/opa/2008/08/edge.shtm and noted in Appendix B.

[63] *See* Appendix B for multiple investigations claiming debt settlement companies represented that they could stop creditors from calling a customer.

[64] Consumer Federation of America, Testimony before the U.S. Senate Committee on Science, Commerce and Transportation, Feb. 26, 2009.

[65] Berner and Silver-Greenberg, *BusinessWeek*, March 6, 2008.

[66] Berner and Silver-Greenberg, *BusinessWeek*, March 6, 2008.

[67] *See, e.g.*, FTC claims against Better Budget Financial Services (BBFS) in Appendix B (BBFS promised to negotiate with consumers' creditors for a non-refundable retainer fee, monthly administrative fees of $29.95 to $39.95, and 25 percent of any savings realized by a debt settlement).

[68] Consumer Federation of America, Testimony before the U.S. Senate Committee on Science, Commerce and Transportation, Feb. 26, 2009.

[69] *Id.*

[70] "Look Out for That Lifeline, Debt-Settlement Firms are Doing a Booming Business—And Drawing the Attention of Prosecutors and Regulators," *BusinessWeek*, March 6, 2008.

[71] Uniform Law Commissioners, "A Few Facts about the Uniform Debt-Management Services Act of 2005, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-udmsa.asp. The National Consumer Law Center and Consumer Federation of America opposed including provisions regulating debt settlement firms in the same law that regulated debt management and credit counseling because the businesses are so different. The highly questionable debt settlement business model necessitates a different and more stringent regulatory framework that does not legitimize the debt settlement.

[72] Loonin, Deanne, National Consumer Law Center, "An Investigation of Debt Settlement Companies: An Unsettling Business for Consumers," March 2005.

[73] Federal Trade Commission, Credit Practices Rule: Statement of Basis and Purpose and Regulatory Analysis, 49 Fed. Reg. 7740, 7744 (March 1, 1984).

[74] Even if, as is common, there are insufficient funds in the account when the check is written, it would not be a crime under most, but not all, states' criminal bad check laws, because the payee knows that and agrees to delay deposit. More than that, the payee choose to go into business to do precisely that.

[75] 10 U.S.C. §987(e)(5); 32 C.F.R. 232.8(a)(5).

APPENDIX A

AUTO LOAN KICKBACKS AND "YO-YO" SALES: A DETRIMENT TO WORKING AMERICANS

Center for Responsible Lending

Consumers that finance their auto loan directly through a dealership are too often in jeopardy of finance and insurance staff looking to increase their individual compensation by overcharging their customers. In recent years, dealers have made more money financing the debt associated with a vehicle, than through the sale of the vehicle itself.[1] Therefore anything that inflates the vehicle cost and financing will also increase commission.

The Center for Responsible Lending recently looked at four major auto lending practices that leave consumers vulnerable to abuse, including two which are singled out in H.R. 2309 for attention: dealer reserve kickbacks and "yo-yo" scams. This is a summary of our findings as to those two specific abuses.

<u>Finding 1:</u> Dealer kickbacks in dealer-arranged auto financing cost consumers over $20.8 billion in 2007.

- Dealer kickbacks result in an extra 0.6 to 1.8 percentage points for new and used car loans, respectively, and an average cost of at least $647 per vehicle.[2] However, since not every car buyer receives an increased interest rate, the impact on the customers who do is much higher. According to data from five major captive auto lenders, consumers seeing loan kickbacks saw an average markup of **$989 per vehicle**.[3]
- According to our survey data, close to half of borrowers trusted that their dealer would give them a good rate, and therefore did not attempt to negotiate.[4] These respondents paid an interest rate at least **2 percentage points** higher than others.
- With automated technology, F&I staff spent only around a half hour with each customer in 2007, even less if the consumer has taken a test drive.[5] With a kickback bringing in at least an additional $647 in profit on average, the dealer will stand to gain over **$1,097 per hour** of service. Dealers should not be compensated for putting consumers in *worse* loans than they qualify for.
- Prior research shows strong evidence of racial discrimination, where African-Americans saw kickbacks over $427 greater than those seen by Whites.[6] Moreover, 54.6% African-Americans were also marked up as opposed to 30.6% of Whites.
- Some finance lenders have self-imposed rate caps of between 2 and 3 percentage points after allegation of racial discrimination with kickbacks. A five-year loan on a $15,000 vehicle with a 10% APR will still net $1,355 in additional revenue for the dealer and lender if marked up to a 3% cap. Whereas rate caps may address racial disparities, they only ensure that consumers are taken advantage of equally across the board.

***Finding 2:* A quarter of low-income respondents have experienced a "yo-yo scam", and having a yo-yo scam led to a 5 percentage point higher interest rate compared to others with the same risk.**

- The overall prevalence of yo-yo scams in our survey were low, with only 4% of respondents having experienced a yo-yo scam.[7] However, among people with low incomes or low credit scores, yo-yo scams were much more common.
- Eleven percent of people with fair or poor credit scores had experienced a yo-yo scam, and this difference was statistically significant.[8] Among people with incomes below $40,000, 12% had experienced a yo-yo scam, and this difference again was statistically significant.
- For people with incomes of $25,000 or less, a quarter reported having experienced a yo-yo scam. Controlling for risk factors such as credit rating and income, consumers in yo-yos experienced rates that were 5 percentage points higher than their counterparts.

Figure 1: Prevalence of "Yo-Yo" Scams

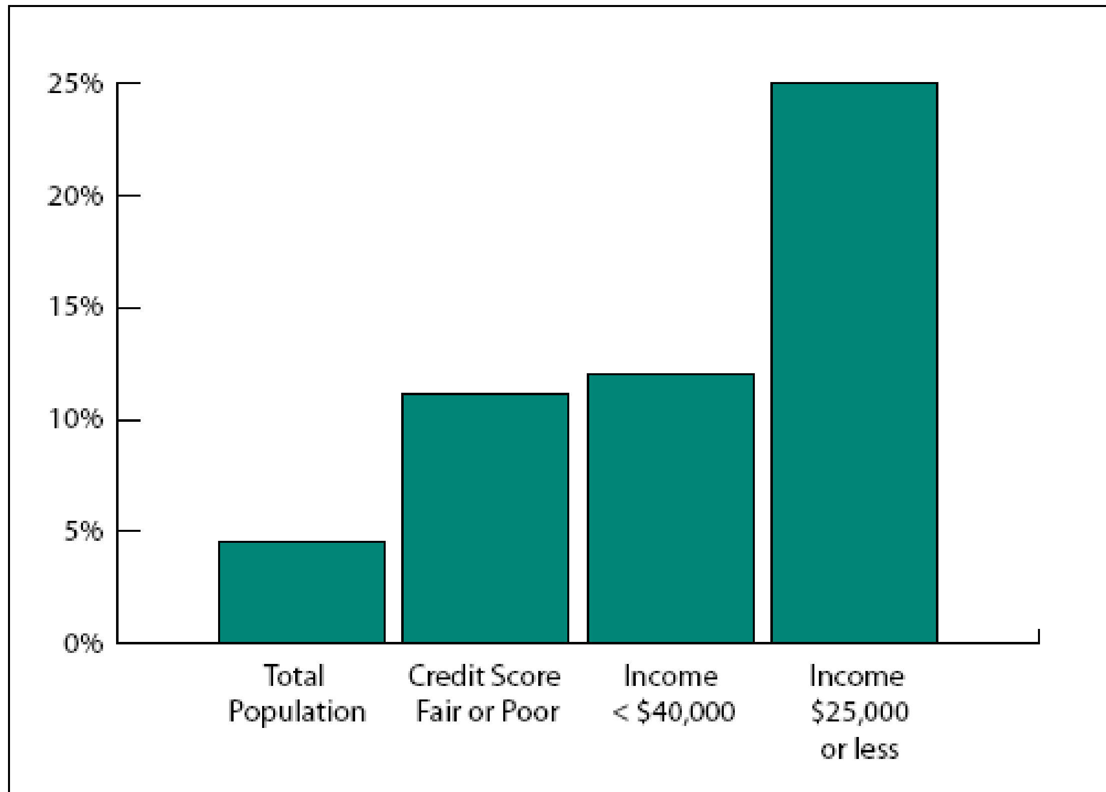

Figure2: Dealer Kickback Volume Estimates by State in 2007 [9]

State	U.S. Rank	New Vehicle Market Share	New Vehicle Kickback Volume	Used Vehicle Market Share	Used Vehicle Kickback Volume	Total Kickback Volume
Alabama	26	1.26%	$110,476,064	1.65%	$199,560,418	$310,036,482
Alaska	50	0.11%	$9,914,978	0.21%	$26,035,577	$35,950,555
Arizona	13	2.61%	$228,410,644	2.11%	$256,264,673	$484,675,317
Arkansas	35	0.85%	$74,402,532	0.90%	$109,059,142	$183,461,674
California	1	12.11%	$1,057,992,630	11.95%	$1,448,752,786	$2,506,745,416
Colorado	22	1.61%	$140,493,995	1.47%	$178,025,775	$318,519,771
Connecticut	30	1.17%	$102,079,879	1.10%	$132,847,890	$234,927,769
Delaware	49	0.31%	$26,820,950	0.21%	$25,634,228	$52,455,178
DC	46	0.26%	$22,468,182	0.15%	$18,663,357	$41,131,539
Florida	4	5.77%	$504,151,195	5.56%	$674,680,597	$1,178,831,792
Georgia	8	3.70%	$323,065,213	3.36%	$407,671,641	$730,736,855
Hawaii	42	0.33%	$28,538,113	0.30%	$36,936,277	$65,474,390
Idaho	39	0.55%	$48,427,492	0.49%	$58,969,272	$107,396,765
Illinois	6	4.52%	$394,937,006	4.02%	$487,602,027	$882,539,032
Indiana	16	2.18%	$190,226,706	2.02%	$245,349,422	$435,576,129
Iowa	27	1.35%	$118,358,410	1.20%	$145,118,756	$263,477,166
Kansas	32	0.99%	$86,458,502	0.96%	$116,945,478	$203,403,980
Kentucky	20	1.59%	$138,588,600	1.62%	$197,001,967	$335,590,567
Louisiana	25	1.31%	$114,836,696	1.63%	$197,071,081	$311,907,778
Maine	41	0.31%	$27,066,509	0.34%	$41,375,372	$68,441,881
Maryland	18	1.99%	$173,845,933	1.93%	$233,483,543	$407,329,476
Massachusetts	17	2.16%	$189,055,715	1.80%	$218,817,918	$407,873,633
Michigan	10	3.42%	$298,616,832	2.79%	$337,914,435	$636,531,267
Minnesota	24	1.43%	$124,807,602	1.56%	$189,653,997	$314,461,600
Mississippi	33	0.94%	$82,106,608	0.91%	$110,868,246	$192,974,854
Missouri	19	1.67%	$145,547,261	1.88%	$228,497,594	$374,044,855
Montana	43	0.29%	$25,054,850	0.27%	$33,335,045	$58,389,895
Nebraska	38	0.46%	$40,522,425	0.55%	$67,216,943	$107,739,369
Nevada	31	1.12%	$98,264,544	0.91%	$109,960,057	$208,224,601
New Hampshire	40	0.38%	$33,358,404	0.41%	$50,043,793	$83,402,197
New Jersey	11	3.01%	$263,222,301	3.05%	$370,352,203	$633,574,504
New Mexico	36	0.73%	$63,723,788	0.86%	$104,451,505	$168,175,293
New York	3	6.23%	$544,292,611	6.61%	$801,815,017	$1,346,107,627
North Carolina	9	2.97%	$259,900,705	3.34%	$405,176,242	$665,076,947
North Dakota	48	0.20%	$17,265,135	0.21%	$26,004,051	$43,269,186
Ohio	7	3.48%	$303,940,474	3.86%	$467,821,924	$771,762,398
Oklahoma	29	1.09%	$95,642,921	1.20%	$145,106,631	$240,749,552
Oregon	28	1.09%	$94,914,110	1.23%	$149,702,143	$244,616,253
Pennsylvania	5	4.11%	$358,910,664	4.47%	$541,872,721	$900,783,385
Rhode Island	45	0.27%	$23,919,687	0.28%	$33,479,337	$57,399,024
South Carolina	23	1.34%	$117,471,427	1.62%	$197,001,967	$314,473,394
South Dakota	47	0.21%	$18,698,289	0.27%	$32,424,430	$51,122,719
Tennessee	15	2.07%	$180,501,359	2.33%	$282,904,093	$463,405,452

Texas	2	7.85%	$685,630,944	7.90%	$957,842,960	$1,643,473,904
Utah	34	0.87%	$76,438,659	0.88%	$107,201,537	$183,640,196
Vermont	44	0.26%	$22,817,732	0.29%	$34,694,298	$57,512,030
Virginia	12	2.85%	$248,819,979	2.84%	$343,969,840	$592,789,819
Washington	14	2.31%	$202,267,821	2.24%	$271,233,432	$473,501,253
West Virginia	37	0.67%	$58,205,272	0.51%	$62,381,349	$120,586,621
Wisconsin	21	1.52%	$133,240,489	1.57%	$190,286,941	$323,527,431
Wyoming	51	0.11%	$10,024,212	0.13%	$16,281,936	$26,306,148
Total U.S.		**100.00%**	**$8,738,743,050**	**100.00%**	**$12,125,361,864**	**$20,864,104,914**

APPENDIX A.1 DATA AND METHODOLOGY

In order to quantify the scope of dealer reserve kickbacks in the industry, we relied on two sources of data that are routinely cited. The Consumer Bankers Association (CBA) conducts a semi-annual Automotive Finance Survey that includes 32 banks and finance companies that submitted over 12.5 million account records for 2007, the most full-year data available. It includes information on average buy and contract rates, as well as the dollar amount of kickback costs by grouping of LTV ratios, FICO levels and loan terms. Total outstanding accounts, auto loans, and related costs, for all 2007 survey participants was $223 billion.

Additionally, CNW Marketing Research Inc. has been respected as an industry source for auto manufacturing, sales, and financing for years. For the purposes of our research, CNW was used to ascertain the levels of new and used vehicle sales financed directly through dealerships. This allowed us to take weighted averages of kickback levels by cross-referencing sales data with dealer-arranged financing to kickback data in the CBA survey. CNW Marketing Research also provided data on state-by-state market shares for 2007 sales.

In order to gain further perspective of the potential predatory nature of auto lending CRL commissioned Macro International to conduct a national survey through their ongoing CARAVAN® survey. The survey was designed to gauge the customer's awareness of abuse, and their ability to negotiate for better rates and terms. The survey also allowed us to gather data on yo-yo deals and auto binding mandatory arbitrations, information not readily available elsewhere. The consumer-level survey data allowed us to use multiple regression to analyze the impact on the loan APR (annual percentage rate) while controlling for other credit risk factors and borrower demographics.

Survey Model

All variables used for statistical analysis came from a telephone survey commissioned by the Center for Responsible Lending. The survey was conducted among a national probability sample of 1,007 adults (505 men and 502 women 18 years of age and older) living in private households in the continental United States. Interviewing for the survey was completed during the period November 21-24, 2008.

81% of survey respondents owned a car or truck. White respondents were significantly more likely to own a vehicle than African-American or Latino respondents. About a quarter of the survey population (27%) used a loan at the dealership to purchase their car or truck. The remainder of the survey focused on this subpopulation, leaving a sample size for these questions of 268 respondents (with a smaller sample size used for analyses involving questions where some respondents chose not to answer).

The survey was conducted by Macro International as part of its regular CARAVAN® survey. All CARAVAN interviews are conducted using Macro International's computer assisted telephone interviewing (CATI) system. Macro International utilizes an unrestricted random sampling procedure that controls the amount of serial bias found in systematic sampling to generate its random-digit-dial sample. The sample is fully replicated and stratified by region. Only one interview is conducted per household. Unlike published directories, the probability telephone sample includes both unlisted numbers and numbers issued after publication of the directories. All sample numbers selected are subject to up to four attempts to complete an interview. Completed interviews are weighted by four variables: age, sex, geographic region, and race, to ensure reliable and accurate representation of the total population, 18 years of age and older. The raw data are weighted by a custom designed program which automatically develops a weighting factor for each respondent. All regressions shown in this report are for weighted results.

The income variable used in this analysis is a 1-10 scale, based on ten standard income ranges used in the CARAVAN survey. Credit rating was a number from 1-4 based on a four-category scale ("excellent," "good," "fair," or "poor"), with a 1 indicating the best credit rating. A cut-off of 5% was used to come up with a non-incentive APR in some regressions. In the first half of 2008, the average rate for borrowers with a credit score above 720 (the highest category) was 6.1%, making it unlikely that many unsubsidized loans by the manufacturer have rates lower than 5%.[10] This distinction was made because the dynamics of many of the issues studied (particularly the negotiation of APR) may be different for respondents receiving a subsidized rate.

While we believe our interpretation of the results yields the most likely cause of the statistical results, it should be noted that any survey has the potential for bias. This bias becomes more important if it can be a source of correlation between individual questions. For example, if people have a tendency to either believe or state their situation is more positive than it is, they may indicate their credit rating is better than it is, their income is higher than it is, and also indicate their APR is lower than it is. This would cause an appearance in this case of risk-based pricing even if there was not any. On the other hand, optimistic responses will also tend to reduce the stated prevalence of exploitative practices. Yo-yo scams, binding mandatory arbitration, unsuccessful loan negotiation, and other adverse indicators may be more common than the survey results suggest. Lack of knowledge may also play a role in survey interpretation. For example, while some people acknowledged that they know they received add-on products without realizing it at the time of sale, it is likely that others did not learn about receiving these products

later. Therefore the frequency of being charged for add-on products without knowing it is probably higher than the results here indicate.

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[1] F&I Management and Technology Magazine, Dec 2008. (In 2008, F&I contributed over half (52.1%) of the average dealership's yearly profit.) Whereas, gross profit margin as a percentage of selling price has fallen from 6.5% to 5.0% between 1999 to 2007. (National Auto Dealers Association, 2008)

[2] Consumer Bankers Association, 2008 Automotive Finance Study: An Analysis of 2007 Year-End Data.

[3] Mark A. Cohen, Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Vanderbilt University (Dec 2006).

[4] Data acquired through a Center for Responsible Lending-commissioned survey conducted through Macro International's CARAVAN interviews and includes a sample size of 1,007 customers across the U.S., 81% of whom owned a car or truck as of Nov 2008. The primary findings are based on approximately a quarter of those respondents (sample size of 268) who reported using a loan financed through their car dealership.

[5] F&I Factors: F&I Management & Technology annual data release. Dec 2007. (Customer spends 35.4 minutes with F&I staff. If consumer has taken a test drive, the average time drops to 18.1 minutes. For 2008, the amount of time increases to 51.5 minutes, or 27.2 minutes if consumer takes a test drive. This is the only year in recent history where F&I has taken as much time with consumers.)

[6] Mark A. Cohen, Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation, Vanderbilt University (Dec 2006). Figures are weighted averages using data from five major auto finance companies compiling 12.6 million records between 1993 and 2004.

[7] See endnote 4 about survey data.

[8] All group differences discussed in this paragraph were statistically significant using a Chi-square or Fisher's Exact Test at the 1% level. Also, the average income difference between those with yo-yo loan experience and those without was significant at the 0.1% level.

[9] State market shares retrieved from CNW Market Research 2007 data. Markup totals based on estimates using term data from CBA Automotive Finance Survey.

[10] *2008 Automotive Finance Study: An Analysis of 2008 Mid-Year Data*, Consumer Bankers Association (2008).

APPENDIX B

RECENT FTC DEBT SETTLEMENT CASES

1. Edge Solutions, Inc. and Money Cares, Inc. aka The Debt Settlement Company and The Debt Elimination Center; Pay Help, Inc.; Miriam and Robert Lovinger
Press release on August 5, 2008 at: www.ftc.gov/opa/2008/08/edge.shtm
Complaint filed on October 3, 2007
Complaint alleged that the defendants:

- Promised that they could reduce consumers' debts so they would only pay 55 cents for each dollar of debt.
- Told consumers that their payments would cover both negotiated debts and fees.
- Told consumers to stop making payments to and have no further contact with their creditors, and that this would place them in a "hardship condition," making negotiations possible.
- Promised that debts would be begin to be paid to creditors within several weeks and would ultimately be paid in a shorter time, and for a reduced amount, than if consumers continued to pay.
- Required consumers to set up direct debit from their bank accounts to a bank account controlled by the company, from which their fees and debts would be paid.
- Promised one-on-one financial counseling, which in most cases was never provided.
- Buried in the agreement the fact that consumers must pay 45 percent of total fee upfront before any payments would begin to creditors and that this might take several months.
- Failed to negotiate with and pay creditors as promised.
- Caused consumers to incur late fees, finance charges, overdraft charges, and negative information on their credit reports, and to face various types of legal action by creditors, leaving them in worse financial condition than before.

Status: Settlement

2. Debt-Set, William Riggs, Leo Mangan, Resolve Credit Counseling, Inc., and Michelle Tucker
Press release on February 14, 2008 at: www.ftc.gov/opa/2008/02/debtreduct.shtm
Complaint filed on March 27, 2007
Complaint alleged that the defendants:

- Falsely promised that they could significantly reduce consumers' credit card interest rates to between 0 and 9 percent or reduce the amount of their unsecured debt to 50 percent or 60 percent.
- Encouraged consumers who called in response to ads to enroll in a "debt consolidation program" if their unsecured consumer debt was up to one month

overdue, or in a "debt settlement program" if they were overdue by a longer period.

- Misrepresented that they would not charge consumers any upfront fees before obtaining the promised debt relief and buried inadequate fee information in the agreement, when in fact they generally charged 8 percent of the total debt before they would contact the creditors.
- Sent consumers documents to sign that were described as "not contracts" but "just information" but in fact were agreements that, among other things, authorized the companies to make withdrawals from consumers' bank accounts.
- Misrepresented that participation in their program would stop creditors from calling or suing consumers to collect debts.
- Failed to negotiate with and pay creditors as promised.
- Caused consumers to incur late fees, finance charges, overdraft charges, and negative information on their credit reports, and to face various types of legal action by creditors, leaving them in worse financial condition than before.

Status: Settlement

3. Homeland Financial Services, National Support Services LLC, United Debt Recovery LLC, Freedom First Financial LLC, and USA Debt Co, LLC, Financial Liberty Services, and their principals, Dennis Connelly, Richard Wade Torkelson, and Joanne Garneau (doing business as Prosper Financial Solutions)
Press release on September 21, 2006 at: www.ftc.gov/opa/2006/09/nationwide.shtm
Complaint filed on September 21, 2006
Complaint alleged that the defendants:

- Falsely claimed that, for a non-refundable fee of up to 15 percent of a consumer's unsecured debt, they could reduce all of their unsecured debts, including credit card balances and medical bills, by as much as 40 percent to 60 percent.
- Falsely represented that they would contact consumers' creditors immediately.
- Charged a nonrefundable fee of 12-15 percent of the total debt.
- To the extent that they initiated negotiations with creditors, these settlements typically began only after a consumer paid 30 percent to 40 percent of the fee. This could take up to three months after a consumer followed the advice of the settlement firm and stopped making payments to creditors.
- Rarely negotiated settlements with all of a consumer's creditors, and even when they have successfully negotiated an account, in many cases, the settlement amount is significantly more than 60 percent of what consumers owe.
- Caused most consumers, who typically left the program within six months of enrolling without completing it, to incur larger debt as a result of penalties, fees, interest, and other charges.
- Failed to adequately disclose the likelihood that consumers would be sued if they took the defendants' advice and stopped making payments to creditors.
- Falsely advised consumers that negative information that appeared on their credit report as a result of participating in the defendants' program would be removed upon completion of the program.

Status: Settlement for some of the defendants, injunctions still in place on others.

4. Innovative Systems Technology, Inc., dba Briggs & Baker; Debt Resolution Specialists, Inc., Todd A. Baker; and Jack Briggs, aka John Briggs
Press release on July 19, 2005 at: http://www.ftc.gov/opa/2005/07/briggsbaker.shtm
Complaint filed February 13, 2004
Complaint alleged that:

- Innovative Systems Technology, Inc., which did business as Briggs & Baker and Debt Resolution Specialists, Inc., falsely told consumers they could negotiate with their creditors and reduce their debt.
- Consumers were told to end all contact with their creditors and to stop making payments on their accounts.
- However, Innovative Systems Technology, Inc., never did negotiate with the consumers' creditors and consumers often ended up deeper in debt and incurred further damage to their credit ratings.

Status: Settlement. Both companies are now currently in Chapter 7 bankruptcy and barred from selling any debt negotiation services in the future.

5. National Consumer Council, London Financial Group; National Consumer Debt Council, LLC; Solidium, LLC; J.P. Landis, LLC; Financial Rescue Services, Inc.; Signature Equities, LLC; M&L Springfield Trust; PC Hailey Trust; Via Lido Trust; and United Consumers Law Group
Press release on March 30, 2005 at: www.ftc.gov/opa/2005/03/creditcouncel.shtm
Complaint filed April 23, 2004
Complaint alleged that:

- National Consumer Council, a purported nonprofit organization, solicited customers through an aggressive telemarketing and direct mail advertising campaign that falsely promised free debt counseling.
- In fact, NCC's role in the scheme was simply to generate leads for the other defendants who then charged consumers thousands of dollars in fees to enroll in their debt negotiation programs.
- The defendants deceptively claimed these programs were an effective way to stop creditors' collection efforts and eliminate debts.
- The defendants failed to disclose important information to consumers before they enrolled, including the fact that very few people were able to reduce their debts through the debt negotiation programs; consumers would suffer late fees, penalties, and other charges; and that participation in the program might hurt their credit rating.
- Very few consumers were helped; a court-appointed receiver determined only 1.4 percent of the consumers who enrolled in the defendants' debt negotiation programs – 638 out of 44,844 consumers – actually completed them. Forty-three

percent of NCC's clients cancelled the program after incurring fees of 64 percent of the total amount remitted to NFCC.

Status: Settlement

6. Jubilee Financial Services, Jabez Financial Group, Gustavsen Learning Centers, Inc., and Debt Relief Counselors of America, P.C. et al
Press release on January 26, 2005 at: www.ftc.opa/2005/01/jubilee.shtm
Complaint filed August 19, 2002
Complaint alleged that defendants:

- Lured consumers with false promises that consumers who enrolled in their debt negotiation program would be able to pay their debts at a reduced amount of 40 to 60 percent and that consumers would stop receiving collection calls from creditors.
- Told consumers to stop making payments to creditors so that they would be in a "hardship condition" that would make it easier to negotiate.
- Misled consumers about the effects of the Jubilee program on their credit report and failed to tell consumers that, as a result of using the defendants' services, negative information would appear on consumers' credit reports and stay there for seven years.
- Falsely told consumers that money sent to the Jubilee companies would be held in a trust account to be used by defendants to pay off consumers' debts at a reduced rate, when instead the companies withdrew the funds to pay operating expenses.
- Failed to negotiate with and pay creditors as promised.
- Caused consumers to incur late fees, finance charges, overdraft charges, and negative information on their credit reports, and to face various types of legal action by creditors, leaving them in worse financial condition than before.

Status: Permanent injunctions against defendants

7. Better Budget Financial Services (BBFS) and its principals, John Colon, Jr. and Julie Fabrizio-Colon
Press release on November 15, 2004 at: www.ftc.gov/opa/2004/11/bbfs.shtm
Complaint filed November 15, 2004
Complaint alleged that the defendants:

- Falsely claimed that they could negotiate with consumers' creditors to reduce their debt by as much as 50 to 70 percent.
- Promised to negotiate with consumers' creditors for a non-refundable retainer fee, monthly administrative fees of $29.95 to $39.95, and 25 percent of any savings realized by a debt settlement, resulting in consumers paying hundreds or even thousands of dollars in fees.
- Told consumers to stop paying their creditors directly, claiming that consumers' failure to pay their creditors will demonstrate a "hardship condition" that will enable BBFS to negotiate on their behalf and instructed them to set a bank

account into which to deposit a specific amount each month to cover the fees and negotiated debt amounts.

- Claimed that they would settle each creditor's account once the consumer saves half the amount owed on each debt.
- Told consumers to sign power of attorney forms, claiming that the forms would enable BBFS to contact creditors on the consumers' behalf and instruct debt collectors to stop calling consumers directly.
- Instructed consumers not to talk to any creditors who contacted them directly.
- Told consumers that negative information may appear on their credit reports while they worked with BBFS, but that the information was temporary and that BBFS would direct consumers to a company to get assistance repairing their credit.
- Failed to negotiate with consumers' creditors or to contact debt collectors as promised, even after consumers called to let them know that they had sufficient funds set aside to pay a settlement.
- Caused consumers to incur late fees, finance charges, overdraft charges, and negative information on their credit reports, and to face various types of legal action by creditors or to file for bankruptcy, leaving them in worse financial condition than before.

Status: Settlement