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The Price of Bailout: A New Era in Consumer Credit Regulation

by Philip S. Corwin, AICCCA Creditor Representative

In the fall of 2008 the Federal government began a massive “bailout” of the financial services sector. The unprecedented expenditure of hundreds of \$billions in capital to prevent economic meltdown carried a heavy price tag – not only in repayment liabilities and controls on executive compensation but in rigorous new regulation designed to prevent a recurrence of high-risk practices and to implement the new Administration’s very different vision of what 21st century financial regulation should look like. Although far removed from the central causes of the financial crisis, credit card issuers were unable to halt or even make major changes to newly enacted legislation that inalterably changes their business practices, most especially their ability to make swift changes in terms and conditions in response to perceived increases in borrower risk.

And the entire financial services sector (outside of securities and insurance) now confronts the Administration’s proposal to consolidate consumer protection in a single agency separated from safety and soundness concerns and with the power to mandate government-designed and approved “plain vanilla” products. Regardless of how this current debate is resolved, the consumer credit world of the past several decades – with its regulatory emphasis primarily on disclosure and its freedom to innovate and take risk, all under a public policy mandate to disperse credit widely to all consumers (including those deemed “subprime”) – appears gone with the recessionary wind. The consumer credit realm going forward will be a very different place, with profound implications for financial institutions, the economy, and most assuredly for the credit counseling and consumer education sector.

Indeed, both the newly enacted credit card legislation and the proposed consumer regulator will likely have profound effects on credit counseling agencies and the environment they operate within.

The CARD Act

On May 22, 2009 President Obama signed the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009. This landmark legislation cleared the Senate by a lopsided, bipartisan margin of 90 to 5, followed by passage in the House the following day by 361 to 64.

The major provisions of the CARD Act (see Appendix I) dramatically alter the rules for credit card issuers. Overall, the ability to re-price the risk of past borrowing is greatly inhibited, and various types of fees (and their income) are curbed. As a result, the credit card environment of the next decade may look very much like that of the 1980s, when annual fees and higher, indexed interest rates predominated for all borrowers and individual credit limits were substan-

tially lower. Consumers used to low interest balance transfer offers will likely see them disappear, as one provision of the Act requires that partial payments always be credited first to the highest rate portion of the outstanding balance. Both prime borrowers (because a lender's ability to raise interest rates if they start to exhibit higher risk characteristics is curbed) and subprime borrowers (because they already are risky) will experience reduced borrowing options.

The economic impact on card issuers will be profound. JP Morgan Chase CEO Jamie Dimon recently estimated that card profits at his institution will be down by \$700 million in 2010 due to the Act's effects. Across the industry profits will be down by \$billions, with overall profit margins on outstanding credit extensions substantially reduced.

While the entire Act does not take effect until August 2010, it is already affecting industry practices as they come under continuing scrutiny. On July 9, 2009 Senate Banking Committee Chairman Chris Dodd wrote to five financial regulators expressing his concern that some credit card companies were reportedly raising consumers' rates in contemplation of CARD Act's future effects. Dodd's letter noted that the Act requires a review every six months of any account where the interest rate has been raised since January 1, 2009, and requires issuers to reduce the rate if the cardholder has become less risky in the interim. Meanwhile, the Federal Reserve has begun to consider new regulations to implement CARD Act provisions, and has asked for comment on such questions as the information that should be used by issuers to evaluate consumers' repayment ability; the factors that should be considered when setting interest rates; and the factors that should go into determining whether a fee or charge is reasonable and proportional to the consumer's violation of the card agreement.

Over time, lessened credit card availability will likely propel consumers' shift from credit to debit cards as their primary electronic payment medium. The percentage of the public with credit problems requiring counseling and education may well decline in tandem with lessened credit availability, and a less profitable card industry may further reduce its support of non-profit counseling agencies.

While the long-term effects of the Act on the client base and financial sector support of counseling agencies is speculative, one provision of the Act is quite certain. Card issuers will be required to furnish their customers with a toll-free number to obtain information about accessing credit counseling and debt management services – and referral may only be made to those nonprofit budget and credit counseling agencies approved to provide pre-filing counseling under the authority of the 2005 BAPCPA legislation.

The Proposed CFPA

Consumer advocates have long argued that the bank regulatory agencies have been captured by the industry they oversee; that they accord their consumer protection duties a lower priority than safety and soundness supervision; and that financial institutions engage in "regulatory arbitrage" to exploit gaps in the complex web of the institution-specific financial regulatory structure that has arisen over many decades. More recently, they have specifically charged that the Federal Reserve's failure to promulgate curbs on abusive mortgages helped lay the groundwork the current recession and plunge in housing values. The Obama Administration is quite sympathetic to these views and has therefore proposed the establishment of a single umbrella consumer financial products regulator

with broad and unprecedented powers.

That proposal for a Consumer Financial Products Agency (CFPA) has been strongly endorsed by House Financial Services Committee Chairman Barney Frank and Senate Banking Committee Chairman Chris Dodd. Frank introduced his own free-standing version of the legislation on July 8 (see Appendix II).

But the bill is strongly opposed by Republican members of those Committees, who have introduced their own bill to establish an umbrella banking regulator containing a new office of consumer protection. And many moderate Democrats are also questioning whether the proposal goes too far, and whether many of its operational details make sense. As a result, Chairman Frank announced on July 21 that Committee markup of the legislation would be postponed from the following week until September. Frank voiced his hope that consumer advocates would make their support for CFPA known to elected officials during the August Congressional recess, but Members are just as likely to hear from financial providers of all types who oppose it.

Financial institutions are reacting to the CFPA proposal's sharp break from past regulatory practice – changes that go far beyond consolidating disparate regulatory responsibilities in a single agency. For the CFPA proposal would break from past practice by:

- Separating financial institution safety and soundness considerations from the consumer protection mission.
- Moving from a consumer protection regime that relies primarily on full disclosure, with institutions free to offer and consumers free to choose any product or service, to a regime where the government will design and designate certain “plain vanilla” offerings as standard and require financial companies to determine whether customers have sufficient sophistication and experience to obtain more complex offerings.
- Moving from mandated non-discrimination to an environment where financial companies will have to discriminate between customers to avoid potential liability.

While banks and other financial providers have conceded that the existing consumer protection system needs upgrading, they have expressed concern that the CFPA would curtail innovation; lead to conflicting and duplicative safety and soundness and consumer protection regulations; and put them in the unenviable position of risking litigation if they offer complex products to certain customers, or risking customer ire and loss if they tell them that they are not qualified to be offered a product or service they want. Indeed, a June White Paper issued by the Administration noted that the CFPA would have authority to compel financial institutions to administer “financial experience questionnaires” to their customers. In particular, financial companies are very concerned by the fact that CFPA's powers would be unprecedented in their breadth, and that its regulations would not preempt similar state rules but would merely establish a floor that the states could erect additional requirements upon. CFPA would be funded by new fees on all those it oversees, and these might well be passed along to consumers in the form of higher interest rates and fees.

For these reasons, some two dozen trade groups – including financial associations, but led by the U.S. Chamber of Commerce and including such entities as the Business Roundtable, the Consumer Electronics Association, and the national Automobile Dealers Association – wrote to all House members on July 20.

Their letter questioned “granting unprecedented power and authority to a new agency with very few checks on that agency’s power” and charged that “many of the most critical decisions...are delegated by Congress and left up to the new agency without sufficient oversight”.

While the Treasury Department has vigorously advocated for the CFPA, and the FTC also supports its establishment, all the federal banking regulators – Federal Reserve, FDIC, and OCC – have questioned the need for a new agency, opined that it may do more harm than good, and questioned many of its operational and funding details. Treasury has responded that is little more than an expected defense of regulatory “turf”, but this pushback has emboldened critics of the proposal.

With the opening bell of legislative action off until the fall it is not possible to predict this proposal’s fate. But given its strong support by the Administration and the Chairmen of the two key authorizing committees it is likely to move forward in some form. It may well be that its more controversial elements – such as government-designed products and the withdrawal of federal law preemption – will be dropped, with some added restraints placed upon its scope of authority and ability to impose fees. That would still result in a new agency consolidating a broad array of powers in a single entity.

Credit counselors have important stakes in this debate. Enhanced consumer protections can help prevent many of the financial train wrecks that counselors are asked to fix. But additional regulation and accompanying fess will place greater burdens on financial institutions that are already contemplating reduced income due to the CARD Act.

Plus, counseling agencies could well find themselves caught up in CFPA regulation, as the language of the introduced legislation would subject all providers of financial advice, including credit counselors, to its authority regardless of whether they are for or non-profit. AICCCA will be informing members of the Financial Services Committee that non-profit counseling agencies are already overseen by multiple state and federal regulators and that the cost of such additional regulation could substantially diminish their ability to serve clients.

Conclusion

The enactment of the CARD Act, and the probable creation of a new federal agency to promulgate broad new regulations on consumer financial products and services, will usher in the most profound environmental changes for the credit-granting industry in decades. The pricing flexibility and availability of consumer credit will be significantly restricted, and the consumer credit industry will likely make less overall profit on narrower margins. Over time the legislation may well result in a lower percentage of consumers seeking credit counseling and education, as well as less support for the counseling sector from creditors. Finally, the CFPA has the potential to result in additional regulation and supervision of the entire spectrum of financial services providers, including the non-profit counseling sector.

Appendix I: Key Provisions of the CARD Act

President Obama signed the CARD Act into law on May 22, 2009. While its provisions mandating advance notice of rate increases and the length of billing periods go into effect 90 days after enactment, its other provisions take effect 15

months after enactment in August 2010.

Its key alterations of prior law, as well as its new provisions, are:

Interest Rate Changes

- Bans rate increases and “universal default” on existing balances, eliminating the ability to increase rates on previously borrowed funds.
- Bars rate increases during the first year after a card has been issued and requires promotional rates to be in effect at least six months.
- Prohibits double-cycle billing.
- Requires payments above the monthly minimum to be applied first to the balance with the highest interest rate.

Fee Changes

- Prohibits over-limit fees unless the card holder has opted to exceed their account limit.
- Prohibits charging a fee to accept a payment except in expedited circumstances.
- Requires gift cards to have a minimum life of five years, and limits certain fees.

Disclosure Changes

- Requires full disclosure of late payment penalties and all card agreements to be posted on the Internet.
- Requires 45 days advance notice of all interest rate, fee and finance charge increases.
- Requires issuers to provide individual account holders with disclosure of the length of time and total interest required to pay off a card’s balance if only minimum monthly payments are made.
- Requires bills to be mailed at least three weeks before payment is due.
- Requires card issuers to provide a toll-free number to provide consumers with information about credit counseling and debt management services; referral may only be made to those agencies approved by the Executive Office of U.S. Trustee to provide pre-filing counseling or pre-discharge financial education under the 2005 bankruptcy reform bill.

Changes for Young Borrowers

- Requires issuers of credit to those less than 21 years of age to obtain a co-signer or proof that the applicant can make the payments.

Appendix II: Outline of the Proposed CFPA

On June 30, 2009 the Treasury Department proposed creation of a Consumer Financial Protection Agency in Title X of a comprehensive proposal for reform of financial services regulation, oversight, and failure resolution. On July 8, 2009 House Financial Services Committee Chairman Barney Frank introduced H.R. 3126, the “Consumer Financial Protection Agency Act of 2009” as a free-standing bill, pledging to report it from Committee before the House commences its summer recess on August 3rd. H.R. 3126 is identical to the Administration’s Title X proposal except that it leaves Community Reinvestment Act (CRA) enforcement authority in the Federal reserve for the time being, with its eventual disposition left for broader regulatory restructuring legislation.

As proposed, the structure and unprecedented authority of the CFPA would be the following:

Structure

- CFPA would be an independent agency with a five member Board. Four members would be appointed by the President, including its designated Director; the fifth member would be the head regulator of national banks.
- A separate Consumer Advisory Board would advise and consult with CFPA regarding its functions and to provide information regarding emerging practices and products.
- CFPA would coordinate with other federal and state agencies to ensure consistent regulatory treatment, and with the Financial Literacy and Education Commission to enhance its initiatives.

Funding

- After receiving initial appropriations CFPA would be funded through annual fees or assessments imposed on all financial services providers under its regulatory umbrella.

Coverage

- CFPA would have authority over all “consumer financial products and services” and all persons who directly or indirectly engage in a financial activity including providing such products and services, including transaction processing and advertising or other marketing or solicitation activities.
- **Providers of financial advice, including both for and non-profit credit counseling agencies, would be subject to CFPA regulation and supervision.**
- “Financial activity” includes taking deposits, extending and servicing loans, and a broad range of other financial activities (except for activities regulated by the SEC, and the business of insurance other than credit, mortgage or title insurance).

Mandate and Objectives

- CFPA’s mandate is to seek the promotion of “transparency, simplicity, fairness, accountability, and access” in the consumer financial products and services marketplace.
- CFPA is authorized to act to ensure that consumers have understandable and useful information; are protected from abuse, unfairness, deception and discrimination; that financial markets operate fairly and efficiently with sustainable growth and innovation; and that traditionally underserved consumers and communities have access to financial services.

General Authorities

- Generally assumes the consumer protection authority and enforcement powers from the bank, thrift and credit union regulatory agencies and the FTC, and a number of other agencies. These powers flow from more than a dozen federal statutes, including the Fair Credit Billing Act, Fair Credit Reporting Act, fair debt Collection Practices Act, and Truth in Lending Act.
- Granted exclusive authority to prescribe regulations, issue guidance, conduct examinations, require reports, and issue exemptions in regard to matters within its jurisdiction (but cannot establish a usury limit unless explicitly authorized by law).

Information Collection and Monitoring

- Can require, gather and make public information collected from all covered entities.
- Must conduct effectiveness assessments of all significant regulations or orders that it issues within three to five years after their effective date.

Mandatory Arbitration

- May prohibit or impose conditions or limitations on consumer agreements that require mandatory arbitration of future disputes between the consumer and financial services company if found to be in the public interest and for the protection of consumers.

Specific Authorities

- Prohibition of unfair, deceptive, or abusive acts or practices.
- Prescribe regulations to ensure appropriate and effective disclosures to consumers of costs, benefits and risks of any financial product or service.
- Prescribe regulations and issue orders regarding sales practices.
- May design and prescribe “plain vanilla” standard financial products and services to be offered to consumers.
- Can prescribe regulations imposing duties on covered persons deemed appropriate or necessary to ensure fair dealing with consumers – and can establish duties regarding compensation policies.
- Issue regulations requiring covered persons to make certain information available to consumers in electronic form, and establish standards to promote the development of standardized disclosure formats.

Relationship to State Law

- CFPA regulations do not preempt state law except where inconsistent; however, states can provide greater levels of consumer protection, through specific laws or general unfair and deceptive practices statutes.
- State attorneys general can bring civil actions for violations of the Act of CFPA regulations so long as they provide timely notice to CFPA.

Enforcement Powers

- CFPA has broad administrative powers for investigation and enforcement, including civil investigations, subpoenas, and litigation initiation authority.

Backup Authority

- Existing depository institution regulators and FTC can undertake enforcement actions if CFPA has not initiated such proceeding within 120 days after having received an enforcement notice from such agencies.

Like to plan ahead? Here are some dates for upcoming conferences:

17th Mid-Winter Conference- January 20-22, 2010, Disneyworld’s Contemporary Hotel in Orlando, reduced rate of \$225, call 407-824-3869 and ask for “Association of Independent Consumer Credit Counseling Agencies” block of rooms.

17th Annual Conference-July 21-23, 2010, the Four Seasons Hotel, Washington, D.C., reduced rate of \$245, call 202-944-9157 and ask for “Association of Independent Consumer Credit Counseling Agencies” block of rooms.

18th Mid-Winter Conference-Location and dates TBD

18th Annual Conference-July 19-22, 2011, the Four Seasons Hotel, Washington, D.C., reduced rate of \$245, call 202-944-9157 and ask for “Association of Independent Consumer Credit Counseling Agencies” block of rooms.

Public Relations News

by Ken Scott

AICCCA had a busy June in the media. Dave Jones was quoted in two USA Today stories, one of which appeared on the front page of the main section. As a result of one of the USA Today stories, we were contacted by a reporter with WalletPop.com who interviewed Dave for a follow up. In addition, two different Associated Press personal finance writers included the AICCCA web address in their columns. In total, 40 newspapers and websites featured the AP and USA Today stories.

InCharge Debt Solutions recognized for commitment to customer satisfaction

InCharge Debt Solutions (IDS) has been recognized by the National Business Research Institute (NBRI) for its commitment to customer satisfaction for the second year in a row. The “Customer Satisfaction Excellence” award was conferred on IDS for “dedication to measuring and improving” its customer satisfaction. Special mention was made of IDS’ practice of considering customer as well as employee survey data. NBRI Organizational Psychologist, Dr. Jan West, said that by including this input and having a targeted action plan, “InCharge has realized great gains in employee satisfaction, which drives customer satisfaction.”

Pioneer Connects with the Community

by Nate Anderson, Pioneer Credit Counseling

Pioneer Credit Counseling participated in the 2009 Black Hills Homeless Connect hosted by the Black Hills Homeless Coalition on June 11th. The Homeless Connect event provides information and services all in one place for those less fortunate families and individuals in our community.

The event provided services such as haircuts, eye exams, photographs, toys and books, clothes, and many other amenities. Many local organizations also provided information on their counseling services and programs. We had the opportunity to meet with other groups who share our desire to help individuals through counseling.

We were able to meet with a good percentage of the over 200 attendees and provided them with information about our valuable array of counseling services. We signed individuals up for a group financial counseling session scheduled for the middle of July.

Not only were we able to provide our counseling information to a portion of the over 200 attendees, we were also able to donate our time and energy assisting with the operation of such a great community event. We were excited to be part of such a great cause and we are already looking forward to next year’s event.

Consumer Education Services Inc. partners with North Carolina Cooperative Extension to offer Triangle Residents Pre-Purchase Education Workshops for **Free!**

Triangle Area, NC July 7, 2009 - Consumer Education Services, Inc. and NC Cooperative Extension are pleased to announce Homebuyer Education Workshops will begin this month.

The first Workshop for 2009 will be offered on August 4, 5 and 6 2009 from 6:00 to 8:30 p.m. at the Wake County Office Park off Poole Road. Pre-registration is required and refreshments will be provided. Please call 1-866-635-6414 ext 6003 or email tevans@mycesl.org.

The Homebuyer Education Workshops have already assisted dozens of people who are looking to get involved in real estate, learn more about benefits of living in Triangle, or simply finding out how to go about the purchasing their first home.

The Workshop on August 4th will provide attendees with information about **\$8,000 Tax Credit Program**, current loan options and procedures, and Triangle Area First-Time Homebuyer Program. Additional workshops are also scheduled for September, October, November and December.

The Homeownership Center supports the delivery of a wide variety of housing counseling services to potential homebuyers and current homeowners. Counselors provide guidance, advice, and advocacy to help families and individuals meet their financial responsibilities and improve their housing conditions and choices. The division currently focuses on families that are facing foreclosure and financial crisis; however, it still services clients who are looking to purchase homes.

The Homeownership Center specifically offers the following services:

- Pre-Purchase Counseling
- Homebuyer Education Workshops
- Reverse Mortgage Counseling
- Delinquency Resolution/Foreclosure Prevention Workshops
- Mortgage Delinquency and Default Resolution Counseling.

For more information please contact:

The Homeownership Center

lholmes@mycesl.org

(919) 861-5331

www.housing-counseling.org

Consumer Education Services Inc. announces the Results of their recent customer satisfaction survey.

Raleigh, NC – Consumer Education Services Inc. announces the results of its recent customer satisfaction survey conducted in May 2009 by National Business Research Institute. Over 3,000 of our clients responded to the survey, yielding a response rate that exceeded expectations. Data confirm that CESI's overall customer satisfaction ranking is in keeping with our industry peers. Our clients reported that services provided through our Debt Management Program effectively assisted them in decreasing personal debt and lessening their financial stress.

Consumers completing the survey also indicated a need for ongoing support in their quest for financial independence. This affirms our continued commitment to financial education. In keeping with our mission statement,

CESI remains dedicated to increasing financial education opportunities for clients. With education comes empowerment to achieve and sustain success in the area of personal finance.

As an industry leader we are pleased with the findings of this survey, however we continue to enhance our services and support—with the objective of reaching more individuals and families. We are committed to serving those who seek relief from financial distress through our effective Debt Management Program, while also providing sound financial educational resources.

For more information about CESI's services and the education we offer visit our website at www.mycesi.org or call 1-866-484-5373.



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AICCCA's Members operate over 250 individual offices in 38 States which includes some of the largest agencies in the United States. AICCCA members represent over 630,000 consumers on active debt repayment plans and we counsel and train many times that number annually.