HOUSE COMMITTEE ON ENERGY AND COMMERCE

SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

Hearing on:

Consumer Credit and Debt: The Role of the Federal Trade Commission in Protecting the Public

Tuesday, March 24, 2009

WRITTEN TESTIMONY OF NATHAN BENSON

CHIEF EXECUTIVE OFFICER

TIDEWATER FINANCE COMPANY, INC.

ON BEHALF OF

THE AMRICAN FINANCIAL SERVICES ASSOCIATION

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Good Morning Chairman Rush, Ranking Member Radanovich and Members of the Subcommittee. My name is Nathan Benson, and I am the CEO of Tidewater Finance Company, which was established in 1992 to purchase and service retail installment contracts. The company, based in Virginia Beach, Virginia, has two lines of business: Tidewater Credit Services for consumer goods and Tidewater Motor Credit for auto services. I am here today in my capacity as a Board Director for the American Financial Services Association (AFSA), whose 350 members include consumer and commercial finance companies, auto finance companies, card issuers, mortgage lenders, industrial banks and other firms that lend to consumers and small businesses. AFSA appreciates the opportunity to provide testimony to the Members of the Subcommittee.

Today, I will focus my testimony on the role that the Federal Trade Commission (FTC) has played – and can continue to play – in helping to restore confidence in the financial services industry. I will also address the installment loan industry's importance in providing access to credit to millions of Americans.

FTC: Effective Regulator

The FTC has been very successful in enhancing consumer protection under its current authority. It has addressed the economic crisis in two ways: first, by using its enforcement authority under Section 5 of the FTC Act to pursue bad actors in the subprime mortgage industry, and second, by setting federal policy through guidance and public comment. I'll start by providing some examples that fall into the first category.

The FTC successfully negotiated a $40 million settlement with Select Portfolio Services in November 2003 for engaging in unfair and deceptive practices in servicing subprime mortgage loans. The settlement was modified in August 2007 to provide additional protections to borrowers, including mandatory monthly mortgage statements, a five-year prohibition on marketing optional products such as home warranties, and refunds for foreclosure attorney fees for services that were not actually performed. The FTC also entered into a $65 million settlement with First Alliance Mortgage Company for making deceptive subprime mortgage loans. The FTC distributed the $65 million to nearly 20,000 affected borrowers.

The FTC has successfully pursued other subprime mortgage lenders engaged in what the commission deemed to be inappropriate conduct, including Capital City Mortgage Corporation and Quicken Loans, Inc. In September 2008, the FTC settled charges that EMC Mortgage Corporation and its parent, The Bear Stearns Companies, LLC, violated Section 5 of the FTC Act, the Fair Debt Collection Practices Act (FDCPA), and the FCRA in servicing consumers' mortgage loans, including debts that were in default when EMC obtained them.

In addition to pursuing bad actors in the subprime mortgage industry, the FTC has helped to improve lending practices by issuing guidance and submitting public comments to the federal banking agencies. In June 2007, the FTC released a Staff Report on Improving Consumer Mortgage Disclosures. In addition, the FTC conducted a study on the effectiveness of mortgage loan disclosures and found that current disclosures do not adequately explain mortgage loan terms and costs to consumers. The FTC provided comments to the federal banking agencies that consumers would benefit from a single disclosure that consolidates the disclosure of important features and costs of a mortgage loan and encouraged them to conduct consumer research to ensure that the proposed disclosures would be effective.

In the area of credit advertising and marketing, the FTC has brought numerous enforcement actions against lenders, brokers and others in violation of the FTC Act or the Truth in Lending Act. In mortgage advertising, for example, the commission has brought actions against mortgage lenders or brokers for the deceptive marketing of loan costs or other key loan terms, such as the existence of a prepayment penalty or a large balloon payment due at the end of the loan. The commission settled with three mortgage lenders charged with using ads that touted low interest rates and low monthly payments, but did not adequately disclose that the low rates and payment amounts would increase substantially after a limited period of time.

Moreover, the FTC has used all the tools at its disposal to increase its protection of consumers in the later stages of the credit life-cycle. The FTC has brought enforcement actions against those who engage in unfair or deceptive acts and practices in violation of Section 5 of the FTC Act, as well as against those who violate specific credit statutes, such as the FDCPA and the Credit Repair Organizations Act ("CROA"). The agency has created and distributed extensive consumer education materials about debt collection, debt relief services, credit repair, foreclosure rescue scams, and other financial services topics to assist consumers in financial distress in taking steps to protect themselves. The FTC has conducted cutting-edge empirical research on how to improve mortgage disclosures and engaged in comprehensive policy development activities related to debt collection and debt settlement.

Installment Lending: Beneficial Credit

I'll now move on to installment lending and its role in providing credit to consumers. At the outset, let me say that AFSA shares Congress' concern about predatory lending. We support the goal of protecting consumers from unfair, abusive, or deceptive lending and servicing practices while preserving access to responsible lenders.

The installment lending industry was born in 1916 out of a need to provide credit to working men and women. The Russell Sage Foundation worked with lenders to develop a set a principles by which they would abide in their lending activities. Lenders agreed to make the cost of their loans transparent so that borrowers understood the true cost of the loan. Loans would be structured over a period of time allowing a repayment schedule that was long enough to match the earning power of the borrower. Finally, the lender would price the loan based on the character of the borrower, which was defined as a combination of the borrower's employment stability and previous history with handling credit.

Today's installment lenders are a key element in improving the socio-economic status of poorer citizens and supporting our country's economic health. They do this by adhering to a basic principle of economics: that people should borrow so they can consume based on their permanent income, and that such consumption is the fuel for our economy. Typically, the middle and upper classes borrow through traditional banking and financial services relationships. However, average wage earners with few financial assets, often cannot borrow in this way – traditional banks simply are not equipped to offer products and services to these consumers in a manner that is profitable for the enterprise. As a result, these consumers need access to safe forms of small-sum credit. These are the very products the installment loan industry -- an industry fully and completely regulated and examined at the state level -- have been providing successfully for decades.

Certainly, people turn to installment lenders for a multitude of reasons. Key among these, however, is the need to access small sums to deal with unforeseen circumstances. Take for example, an unanticipated car repair. Keeping one's vehicle in good repair is essential to allow travel to work. Absent access to small sums over and above a wage, the repairs necessary for such travel may not be possible, and could easily result in job-loss. Likewise, the back-to-school period increases the demand for installment loans, as parents look to equip their children appropriately for the coming semester. Many less-advantaged citizens in our country do not have access to the kinds of credit cards and financial offerings available to the more fortunate, and have long relied on access to small-sum installment loans to meet their credit needs. And, they have proven that they can and do make good use of borrowed money, even if they sometimes struggle to demonstrate their creditworthiness to lenders.

While not all small-sum loan products are alike, some view installment lenders and payday lenders through the same lens. However, these two separate industries could not be more different, despite their mutual focus on small-sum lending. Consider the following:

- Installment lenders provide loans in amounts not offered by the traditional banking community. In fact, according to the Federal Reserve Board's recent G-19 report, non-bank financial services companies make 50 – 55% of consumer loans in this country.

- Installment lenders do not impose pre-payment penalties on their customers.
- Installment lenders work out a borrower's ability to repay a loan before making it, using a monthly net income/expense budget based on information provided by prospective borrowers. This ensures that proposed monthly loan payments are affordable.
- Installment lenders check the credit of borrowers when making loans to allow a realistic assessment of the borrower's ability to repay. What's more, installment lenders report to credit bureaus, providing the opportunity for borrowers to build and improve their credit histories. The bureaus do not accept reports from payday lenders. This means that even the most conscientious payday borrower can only be in good standing at the shop with which they have a relationship – their timely payment history and the benefits that brings will never be made known to the mainstream lending industry.
- Installment lenders structure payments as monthly installments, rather than a single payment, in order to provide a manageable method of repayment, allowing borrowers to pay off interest and reduce principal and interest accrual.
- Installment lenders accept and hold the risk of default, with little legal recourse.

Consumer advocates agree. In 2003, a Consumers Union report stated that installment lending " . . .provides a clearly safer and more affordable alternative to high-risk, high-cost payday loans."

As access to credit shrinks, it is important that installment loans are differentiated from other more risky forms of credit and continue to be available to those individuals and families that need them. Installment loans remain a safe option for small-sum credit.

As policymakers grapple with unprecedented economic challenges, care must be taken that new regulatory initiatives do not inadvertently stifle economic recovery. The President himself has talked of the importance of getting credit flowing to consumers and businesses. Any regulation that would restrict this flow runs counter to the intentions of stimulus efforts aimed at kick-starting a stalled economy.

The importance of installment loans as safe, convenient and affordable sources of credit increases in times of economic hardship. Maintaining consumer access to safe forms of credit is an important part of the economic recovery process. Installment loans are already playing their part in this and will serve to extend and support stimulus activities.

The government economic stimulus plan aims to ensure the survival of the banking system and reinvigorate the economy through the government spending component of Gross National Product (GNP). Installment loans provide a direct, immediate boost to consumer spending which is the largest and most dynamic component of GNP, unfiltered by the medium of government grants to commercial banks. Any proposed price cap will eliminate this boost and harm the very consumers the stimulus package is intended to help.

Notwithstanding the tightening in market-based funding, installment lending has continued unabated in the current financial crisis, keeping funds in circulation without any external stimulus. This must be allowed to continue.

Again, Mr. Chairman I appreciate the opportunity to testify here today and would be happy to answer any questions Members may have.