

Testimony of

Mr. Kenneth Beine

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WRITTEN TESTIMONY OF
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ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
BEFORE THE
SENATE JUDICIARY COMMITTEE
ON
S. 256, THE BANKRUPTCY ABUSE PREVENTION
AND CONSUMER PROTECTION ACT OF 2005
FEBRUARY 10, 2005

Good morning, Chairman Specter and other members of the Committee, particularly Senators Feingold and Kohl of my home state. I am Kenneth Beine, president of Shoreline Credit Union in Two Rivers, Wisconsin, and I appreciate the opportunity to be here to tell you about our concerns with bankruptcies and how they are impacting credit unions - and my credit union in particular. I am speaking on behalf of the Credit Union National Association (CUNA), which represents about 90 percent of the 9,100 state and federal credit unions nationwide and their 86 million members.

We are very pleased that the Committee is holding today's hearing on S. 256, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. I sat in front of this committee nearly four years ago today with a message from America's Credit Unions. That message is the same today as it was then. Credit unions recognize that many people legitimately need the option to declare bankruptcy. What concerns us, however, are the cases of abuse by those who file Chapter 7 and totally walk away from their debt, even though they clearly have the ability to repay all or part of that debt.

Credit unions have consistently had three top priorities for bankruptcy reform legislation: a needs based formula, mandatory financial education, and maintaining the ability of credit union members to voluntarily reaffirm their debts. The bill before you today, while a product of compromise, does a good job of balancing these issues. We strongly urge the 109th Congress to pass this compromise bill as soon as possible. Any further dilutions may result in this bill not addressing the real bankruptcy problems facing America's consumers.

Shoreline is a \$64.1 million state-chartered, federally insured credit union. We have a community-based charter, serving everyone who lives or works in Manitowoc County, and have over 11,300 members. Currently we have \$43 million in loans to our members - some \$12 million in car loans, more than \$26 million in home-secured loans. In addition, we have issued about 1,800 credit cards for another \$2 million.

Nationwide non-business bankruptcy filings were nearly 1.21 million in the first nine months of 2004. While final full-year data is not yet available, the results from the first nine months suggest that full-year filings will exceed 1.61 million - nearly equaling the 1.62 million record level set in 2003. The 2004 total is likely to be about 1% lower than in 2003, but the slight slow-down isn't surprising given the improving economy. However, viewed in a broader historical context the results are disturbing: 1.21 million filings is one-third higher than the 2000 total, over double the national total recorded in 1994 and six times higher than the total in 1984.

Furthermore, the current near-record level of filings has occurred in a sharply improving economy. The U.S. economy grew 4.4% in 2004, its fastest increase since 1999. The U.S. unemployment rate averaged 5.2% in 2004, its lowest showing since 2001. While we expect the economy to continue to grow at a healthy pace, we also expect bankruptcy

filings to rise as higher market interest rates impose a heavier debt service burden on the nation's consumers. Household debt levels are at all-time highs and debt service burdens (the amount of take home pay consumers devote to paying debts) are near all-time highs.

Credit unions continue to be very concerned about these trends because their experiences with credit union members who file mirror the national experience. Data from credit union call reports to the National Credit Union Administration (NCUA) suggest that roughly 275,000 credit union member-borrowers will have filed in 2004 - a record number. This figure is 40% higher than the level of filings we witnessed in 2000. In addition, CUNA estimates that over 40% of all credit union losses in 2004 will be bankruptcy-related, and those losses will total approximately \$900 million.

In Wisconsin we expect more than 28,000 total bankruptcy filings in 2004 a 2% increase over the 2003 total. The total number of credit union borrow-bankruptcies is on track to be 70% higher than those we experienced in 2000. This translates to a total of roughly 6,400 filings.

At Shoreline Credit Union, bankruptcy filings and losses have shown a steady increase since 1996. In 1996, losses due to bankruptcy as a percentage of total of all charged-off loans was 4.6 percent. That grew to 20 percent in 1997; 47.2 percent in 1998; 48.5 percent in 1999; 73.2 percent in 2000; 43.2 percent in 2001; 38.2 percent in 2002; 38.2 percent in 2003; 71.9 percent in 2003, and 50.3 percent in 2004. Of the 90 total bankruptcy filings during that period of time, all but 2 were Chapter 7.

As the number of member bankruptcies has increased, so too have the dollar losses to my credit union. Our loss from the one bankruptcy in 1996 was only \$1,875, but in just one year the losses increased to \$9,883 - an increase of over 500 percent. Since then, our losses have increased significantly: in 1998, losses were \$15,309; in 1999, losses were \$34,577; in 2000, losses were \$59,813; in 2001, losses were \$77,177; in 2002, losses were \$113,697; in 2003, losses were \$115,191; and in 2004, losses due to bankruptcy dropped, but were still a robust \$69,624. How much of these losses could have been prevented by a means test is unclear, but if we use the range often associated with abusive filings of anywhere from 3-15 percent, our modest credit union and its members could have saved anywhere from \$15,000-\$75,000 over this period of time.

Shoreline is a careful lender. We cannot afford to be otherwise. We do a good job with scrutinizing loan applications and carefully determining that the applicant is creditworthy before extending credit. We examine credit reports, verify income, and see that a reasonable debt-to-income ratio is maintained by the borrower. We even look at the applicant's disposable income to determine that the applicant can make the payments. We routinely monitor our credit cards and do not make across-the-board increases to the credit limit.

In an effort to combat the number of bankruptcies at the credit union, Shoreline has tightened its credit policies. We now use bankruptcy predictors as part of the credit granting process. We have increased collateral requirements and opt to require a co-signer or co-maker on more loans than in the past. We do not reissue cards to those members who are overextended or have a poor repayment history with the credit union. We have also introduced "risk-based lending" procedures.

If a member is experiencing financial problems and mentions bankruptcy to us, our loan officers inform the member of the downside to such an action - damaged credit, loss of services - and let the member know that the credit union is there to help them through the financial difficulty. We attend all 341 hearings, where creditors are permitted to question the debtor, and encourage reaffirmations by offering debtor-friendly terms.

Credit Unions Support Financial Education

Credit unions clearly recognize the value of financial counseling for their members. According to a recent CUNA bankruptcy survey, 70 percent of credit unions counsel financially troubled members at the credit union. A similar percentage of credit unions may also refer members to an outside financial counseling organization, such as the Consumer Credit Counseling Service (CCCS), and many do both.

Shoreline regularly refers members who are experiencing financial difficulties to the local CCCS and have found the program to be beneficial for the members and their families. We also try to educate our members about alternatives

to bankruptcy. We address credit issues in our newsletter and sponsor annual Consumer Credit and Identity Theft seminars.

CUNA strongly supports the provision in S. 256 that requires a person contemplating bankruptcy to receive a briefing about available credit counseling and assistance in performing a budget analysis. We also strongly support the provision in this legislation that would prohibit the Chapter 7 or 13 debtor from receiving a discharge if the debtor does not complete a course in personal financial management. Any sensible bankruptcy reform should include education requirements to give debtors the tools they need to make wise decisions about filing for bankruptcy and to succeed financially after bankruptcy. In anticipation of this, CUNA plans to develop face-to-face and/or on-line courses to fulfill this aspect of the legislation.

We also strongly support amendments that would require a debt relief agency providing bankruptcy assistance to analyze the benefits of different forms of debt relief with the debtor and to emphasize the need for full and accurate disclosure of assets, liabilities and income.

Credit unions recognize that financial education needs to be available early on and before consumers experience financial problems. We are pleased that a financial management training test program is included as part of S. 256, as well as the provision encouraging states to develop personal finance curricula for elementary and high schools.

At Shoreline, we do our best to implement that philosophy. For example, we now operate a student credit union. It is a joint venture between Shoreline CU, River Wood-Maritime CU and the Two Rivers High School. It is operated by students from their business program over the lunch hour, on-line real time access, able to process deposits, withdrawals and check cashing transactions for both students & staff, with 4 of the 6 students employed (2 each) at our respective credit unions. In addition loan officers and operational staff are tapped as guest speakers to provide insights on lending procedures, the importance of good savings habits, etc.

Financial education is a high priority for our national trade association, too. Five years ago, CUNA and the National Endowment for Financial Education (NEFE) entered into a partnership whereby credit union volunteers teach financial education in our nation's schools. It is based on the philosophy that discipline in managing money is best achieved if it is learned early in life. Many credit unions had already been working with their local schools, as well as devoting office space for consumer libraries that enable members to use a wide range of financial periodicals, manuals, and books to learn more about money management.

Credit Unions have also differentiated themselves from other financial institutions in terms of giving college students credit cards. Many credit unions offer educational sessions on budgeting and using credit wisely on college and university campuses at various times during the year, including freshmen orientation and classes. Education is the key in helping college students to avoid falling into debt at an age where their main focus is on obtaining a college degree. By educating these students, credit unions help them to positively handle their personal finances and to make them even more attractive candidates for credit products such as auto loans and mortgages later in life. Many colleges and universities welcome credit union representatives to teach these courses on their respective campuses and continually ask these representatives to come back year after year.

In that regard, CUNA supports the provisions of the bill that require credit card companies to inform their customers of the financial risks of making only minimum payments, the prohibitions on deceptive advertising of low introductory rates, and the higher penalties for predatory debt collection practices.

I am confident that early financial education would have helped some young adult members of Shoreline Credit Union to make different decisions than they did. In one case, a couple in their mid-twenties decided that they wanted a "clean slate" prior to getting married. They ran up credit card purchases. One prepaid on an auto loan with us to have the cosigner released. (Both were employed full-time.) They both then filed for Chapter 7. My credit union's share of their version of financial planning was a write-off of almost \$3,000 in credit card debt plus another couple of hundred dollars on the disposal of the auto.

In another case, an expectant young mother who lived at home with her parents (with a stable part-time job and a small automobile loan at Shoreline) wanted to quit her job, but didn't want to "burden her child with her credit

problems," and asked if we would accept the car in full payment of the loan balance. My loan officer offered to rewrite the loan terms or suspend payments for several months and also informed her that she would still be responsible for the remaining balance on the loan after the sale of the car. She was not interested. She subsequently filed Chapter 7 and turned over the vehicle to us. We incurred about a \$3,000 loss.

Even with financial counseling, I recognize there are instances in which bankruptcy may be the only alternative for some members, the way for them to get a much needed "fresh start." But I am not convinced that in either of these examples, bankruptcy was the right solution.

Credit Unions Support Reaffirmations as a Benefit Both to the Member and to the Credit Union

Because we are not-for-profit financial cooperatives, losses to the credit union have a direct impact on the entire membership due to a potential increase to loan rates or decrease in interest on savings accounts. Credit unions strongly believe that reaffirmations are a benefit both to the credit union, which does not suffer a loss, and to the member/debtor, who by reaffirming with the credit union continues to have access to financial services and to reasonably priced credit.

CUNA strongly supported the original House-passed bankruptcy bill in the 106th Congress, which did not materially amend the reaffirmation provisions. The bankruptcy bill that eventually passed and is preserved in S. 256, however, contained a lengthy disclosure statement for reaffirmations. The form is intended to assure that debtors entering into a reaffirmation agreement understand all aspects of signing that contract. CUNA appreciates the work of this committee, and the work of Senators Jeff Sessions (R-AL) and Jack Reed (D-RI), to recognize in the Section 203 language the unique relationships that credit unions have with their members.

Shoreline, like most credit unions, has a policy that if a member causes a loss to the credit union, services to that member, aside from maintaining a share account, will be withheld. Most credit union members take this seriously and continue to reaffirm on their credit union loans. However, we are beginning to see that some members do not care if they cause a loss and are denied service because they believe they can get credit elsewhere -- even though it may be at a higher rate. We continue to see more surprise bankruptcies, where the member is a long-time member and is current on his or her debt at the time the bankruptcy petition is received.

But not all stories are bad. Some members truly care about their fellow members and have a strong sense of responsibility when it comes to meeting their financial obligations. We recently had a member couple who had a number of bad decisions catch up with them. They were clearly living beyond their means. They started a business venture during a recession. They were unable to service their loans, so they sold their recreational vehicles (a large boat and a motor home). Their unsecured balance came to \$25,000. Against advice from several quarters, they offered to cover the remaining balance with a second mortgage. We helped them with favorable (7%, 30yr) terms, and they are now on their way to restore fiscal control of their lives.

Perhaps the best way to understand the credit union movement's position that reaffirmation benefits both the member and the credit union is to provide another real life example. We had a middle aged couple file for Chapter 7 due to several medical problems and loss of employment. They reaffirmed their automobile loans with Shoreline. Although not required to repay their credit card loans, they were adamant about doing so, and did so quite voluntarily after discharge. Needless to say, today they are members in good standing, and need only ask to be granted future loans.

Credit Unions Support Needs-Based Bankruptcy

Credit unions are very anxious to see Congress enact meaningful bankruptcy reform and believe that "needs-based bankruptcy" presents the best opportunity to achieve this important public policy goal. Credit unions believe that consumers who have the ability to repay all or some part of their debts should be required to file a Chapter 13, rather than have all their debt erased in Chapter 7. Therefore, CUNA supports the needs-based provision that is contained in S. 256. This provision was a compromise developed out of the bankruptcy reform bills that received overwhelming support in the 106th Congress.

This section is the heart of the bill, taking direct aim at those that abuse the system. While I will provide examples of this abuse below, I want to call your attention to "official" recognition of this problem. The U.S. Trustee Program's Annual Report of 2002 indicates that the Program established a National Civil Enforcement Initiative and increased its

criminal enforcement actions to address this problem. According to the report, "One of the U.S. Trustee Program's most critical responsibilities is to combat fraud and abuse in the bankruptcy system...This effort was undertaken to respond to mounting public concern that the bankruptcy system was being abused and that more should be done to protect the system by identifying and taking action against wrongdoers."

The report includes many examples of such abuse. But let me tell you about a case at my credit union that illustrates why needs-based bankruptcy and its provisions are needed. A young woman had an automobile loan from Shoreline Credit Union, with her mother as a co-signer. The daughter fell behind on the payments, and the mother offered to take over the loan completely if the credit union was willing to remove the daughter's name from the loan. Since the mother had a good credit and employment history, we agreed to do so. The woman filed for Chapter 7 before the due date of the first payment. We lost \$6,000. We eventually learned that she had previously filed for bankruptcy and "didn't want her daughter to have the same credit problems."

And just two years ago we had a gentleman who hit us with a surprise bankruptcy, a few months after sitting in my office and promising to "never cause Shoreline a loss". He turned over several automobiles. We lost \$11,000. He drove a newly leased vehicle to the discharge hearing. He has a documented gambling problem. The discharge included everything from multiple credit cards to payday loans to utility bills. His earnings? Between \$40,000 and 60,000 per year. It turns out this was bankruptcy number 3. He has not changed his spending habits. He will be eligible to file again in 2008.

What this member did borders on fraud. People should not be able to use the bankruptcy code as a tool to avoid inconvenient obligations by transferring their debts to fellow consumers - my members - your constituents. This is wrong. This is abuse.

You have the power to make it right.

Again, let me say that I am pleased you are holding this hearing today. Credit unions are very anxious to see Congress enact meaningful bankruptcy abuse reform and believe that a needs-based bankruptcy system presents the best opportunity to achieve this important public policy goal. This hearing shows that the 109th Congress is continuing to move toward passage of bankruptcy abuse reform legislation, and we hope that bankruptcy reform will become law in the coming weeks.

Thank you, and I will be happy to answer any questions.