the white house

June 25, 2000

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**
SARAH ROSEN WARTELL

SUBJECT: **RESPONSE TO BIDEN LETTER ON BANKRUPTCY**

CC: **JOHN PODESTA**

Below is a brief summary of four basic issues that relate to Senator Biden's letter to you. Following the brief summary is more a detailed analysis of each issue.

I. Brief Summary

1. **Fair Debt Collection Practices Act Amendment:** Senator Biden asserts that Senator Lott intends to drop this provision, if it will avoid a veto. While we have heard similar rumors, we have no assurance that it will happen. Moreover, if the rumor is true, it seems necessary for you to indicate that you will veto over the issue to get Senator Lott to drop the amendment. As we wrote in our earlier memo, this is an especially pernicious provision that has not received any public scrutiny, as it was in neither bill and only added in conference. All the major consumer groups wrote Congress on Friday to express their strong opposition to its inclusion.

2. **Homestead Exemption:** Senator Biden acknowledges that the homestead exemption language in the final bill is not all that we would have sought. He suggests that, because Senator Kohl -- the amendment's original sponsor -- is satisfied, we should be too. The final provision does make it more difficult to move to Texas or Florida on the eve of bankruptcy to benefit from their uncapped homestead exemptions, but it does nothing to prevent a wealthy longtime Texan or Floridian from shielding assets from their creditors in the form of extravagant homes. Under the bill, both moderate-income debtors and their wealthier counterparts will be required to devote a portion of their future earnings for five years to repay their debts; but some will be able to do so while retaining great wealth in their homes. Others (in other states or renters) will be left penniless, liquidating whatever assets they have. That seems fundamentally unfair.

3. **Clinic Violence:** Senator Biden argues that the additional language of the Schumer amendment is not needed. It is true that <u>some</u> judgments that result from clinic violence may be nondischargeable under current law; but there is no doubt that the Schumer amendment would address "a far wider range of potential debtor liability than is currently covered" (Congressional Research Service) and would reduce the litigation barriers that are now being placed before those seeking to collect multi-million dollar judgements against clinic violence defendants. Moreover, the new language that Chairman Hyde offered and the Republicans intend to include will give rise to new questions about what standard of proof Congress intended before a victim can block the discharge of such debts, miring clinic violence victims in yet more litigation.

Whatever legal ambiguity may exist, there is none in the minds of the abortion rights community. They are deeply offended that so many of those who have been found liable for acts of clinic violence and intimidation have repeatedly sought refuge in the bankruptcy system. Similarly, anti-abortion activists and Chairman Hyde have starkly refused any meaningful compromise on the issue, signifying its growing symbolic importance to the broader abortion rights fight. If you signed a bill that failed to include some language to accomplish the goals of the Schumer amendment, the pro-choice community would harshly criticize your decision.

4. **Overall Balance in the Bill:** While we have focused on outstanding amendments, most of your advisors find the basic underlying bill to be unbalanced and unsatisfactory. We agree that requiring debtors with the capacity to repay their debts to do so could lower interest rates, benefiting many Americans, and would be consistent with your emphasis on personal responsibility; however, most of the debtors filing for bankruptcy do not have the capacity to repay and are not abusing the system. A far more balanced bill could have been drafted to accomplish our shared goals without slanting the playing field in many small ways against all debtors. While the improvements that Biden and we achieved in the Senate and conference make this bill better than the flawed House bill, we made significant compromises and lost as often as we won. (See details below.) The lack of balance in the underlying bill remains deeply troubling to the majority of your advisors. (We should note that Secretary Summers has a slightly different view. He agrees that this is not the bill that we would have written and that you should threaten veto pointing to the clinic violence, debt collection, and homestead issues. But he also believes that the remainder of the bill is not sufficiently flawed to justify a veto on the merits, attentive as he is to the economic benefit of lower interest rates that may result from somewhat lower debt write-offs by creditors.)

Finally, we note that Senator Biden has long pressed for bankruptcy reform, perhaps in part because of the strong interest of credit card companies headquartered in Delaware. In fact, the final bill that we now face is the product of an intense lobbying campaign by the credit industry. Many in Congress support or feel compelled to support this bill.

II. Further Analysis

1. **Fair Debt Collection Practices Act (FDCPA):** The FDCPA provides essential protections for consumers from abusive practices by debt collectors including: invasions of privacy, harassment, false or deceptive representations, and unconscionable collection methods. For example, it precludes late night and repetitive phone calls, leaving a message with your employer that you are delinquent on your debts, and false threats of legal action. There was nothing about the FDCPA in either the House or Senate bill, but in Conference Senator Hatch has insisted on a provision that would eliminate attorneys fee awards for violations of the FDCPA, if the defendant is collecting bounced checks rather than other defaulted debt.

   This is a pernicious provision because it could give check collectors de facto rein to intimidate and harass lower-income debtors, knowing that their financial position would prevent them from hiring counsel. The FTC has made clear that there is no policy justification for treating check collectors and other debt collectors differently. Abuses occur in both areas. Moreover, private remedies are an essential aspect of the enforcement scheme under the FDCPA. If a debtor, in financial difficulty, is unable to recover the cost of legal representation from those who are grossly abusing their rights, they will never be able to vindicate those rights. Senator Torricelli suggested a minor change, which the Republicans accepted, that limits attorneys' fees to cases where the debtor can prove that he or she had no intent to defraud. But we agree with Senators Leahy and Sarbanes that such a standard is impossible to prove.

2. **Homestead Exemption:** Senator Biden is largely correct that the language in the bill would prevent a galling form of abuse -- the "last-minute sheltering of assets through the purchase of expensive homes." (Consumer activists believe that, in fact, wealthy debtors will be able to use various techniques to postpone bankruptcy long enough so that the two-year window will not prevent, only limit, the sheltering of assets by wealthy debtors moving their residence to a State with an unlimited homestead exemption.) The language in the final bill does not address our more fundamental concern: does the bill treat moderate-income debtors and wealthy debtors equitably?

   The Washington Post recently ran an editorial entitled "The Rich Win." They wrote:

   > "Bankruptcy reform involves balancing two principles. Debtors must not be allowed to use the law to avoid repaying loans when they can actually afford to do so; on the other hand, debtors should not be forced into serious hardship. The reform in Congress probably will increase hardship: It toughens the rules for ordinary debtors, most of who declare bankruptcy not out of irresponsibility but because of catastrophic medical bills, unemployment, or divorce. At the same time, the reform does too little to clamp down on an egregious loophole known as the homestead exemption, which is used by wealthy debtors."

   The editorial goes on to argue that the minor limitations in the bill on homestead exemptions "won't have much effect." The Post is largely right. A debtor, who has resided in a $10 million, mortgage-free estate in Florida for more than two years, can file for bankruptcy. The wealthy debtor will be allowed to continue to live in that lavish home. However, a moderate-income, Florida resident who rents her home and files for bankruptcy to discharge overwhelming credit card or medical debts, may be forced to move, if her rent is more than allowed under the new formula, based on median area housing costs, that will determine how much of her debt she must repay over the next five years.

3. **Clinic Violence:** Senator Bidden asserts that current law prevents the discharge of judgements stemming from violations of the FACE Act and the Schumer amendment is not needed. While he is arguably right about the former point, the goals of the Schumer amendment were broader and are not fully accomplished by current law or new language proposed by Chairman Hyde.

   The Problem: Under current law, a debtor cannot discharge debts "for willful and malicious injury by the debtor to another entity or to the property of another entity." The Supreme Court has interpreted this "willful and malicious" standard strictly. It held in Kawaauhau v. Geiger, 118 S. Ct. 974 (1998), that the "willful and malicious injury" exception is limited to intentional torts and does not include liability for claims attributable to "negligent or reckless" conduct. Specifically, the Court held that the word "willful" modifies "injury" so that intentional behavior that was not intended to cause injury is not sufficient. Id. at 977. For example, imagine that an activist were to bomb a clinic at night, thinking the facility were vacant, but a security guard was killed. The activist's liability for the physical property damage would be nondischargeable, under current law, but not their liability for the wrongful death of the guard.

   This is not merely a theoretical question for the abortion rights community. Numerous anti-abortion activists found liable for clinic violence and intimidation have filed for bankruptcy and sought to discharge their debts. Six of the 12 "Nuremberg Case" defendants (who posted abortion doctors' names on a website and then crossed out the names of those who were murdered) have now filed for bankruptcy. Each was jointly and severally liable for a judgement of over $100 million. Each filed on the eve of efforts to identify their assets or garnish wages, so as to collect on that judgement. (These cases are still in litigation, so the outcome is not yet clear.) Similarly, Operation Rescue's Randall Terry said, after a judgement was entered against him:

"I cannot in good conscience permit the National Organization [for] Women, Planned Parenthood and others who have profited from abortion to harass my wife and family and possibly get money from me to continue their crusade against unborn life.... Hence I have filed a Chapter 7 petition to discharge my debts to those who would use my money to promote the killing of the unborn."

Schumer's Proposal: The Schumer amendment, adopted by the Senate by a vote of 80-17, would have made nondischargeable any debt that resulted from a judgement, order, consent decree, or settlement agreement (including damages, fines, penalties, costs, or attorneys fees) arising from: (a) FACE Act actions; (b) violations of Federal, State or local law designed to protect access to health care facilities and the provision of health services; (c) violations of any law resulting from actual or attempted harassment, intimidation, interference with, obstruction of, injury to, threat to, or violence against any person who provides or receives health services or that deters a person from obtaining or providing health services; (d) violations of any law resulting in damage to a health care facility; or (e) violation of a court order or injunction protecting access to health care facilities.

The Hyde Alternative: Chairman Hyde proposed an alternative that would make nondischargeable debts "that arise from any judgement, order, or decree entered by a Federal or State court for a willful and malicious threat of serious bodily injury against an individual." Abortion rights activists believe this adds little to current law, because it reiterates the high "willful and malicious" mental state requirement and only involves threats of serious bodily injury.

Analysis:

(1) ***It is true that FACE Act violations would likely be found nondischargeable under current law.*** The FACE Act also has an intent standard. It imposes liability on those who "by force or threat of force or by physical obstruction, <u>intentionally</u> injures, intimidates, or interferes with" the provision of reproductive health services. Therefore, as the Congressional Research Service (CRS) concludes, it is likely that liability under the FACE Act would only be found, if there was an intentional tort of the kind that existing law already covers.

(2) ***The Schumer amendment, however, would make it easier to prevent discharge of FACE Act judgements and reduce litigation:*** CRS also found that it would be "easier" for the clinic violence victim to establish that FACE Act liability should be nondischargeable under the Schumer amendment than under current law. Under current law, they must make a special request for a court determination of nondischargeability and prove that the conduct underlying the liability was actually "willful and malicious."
Neither would be required under Schumer. Abortion rights advocates argue that beleaguered clinics and victims should not have to endure yet more litigation and cost when trying to assert their lawful claims.

(3) ***The Schumer amendment would cover many other types of clinic access judgements not nondischargeable under current law.*** The Schumer amendment sought to address discharge of a range of penalties that would not meet the "willful and malicious" standard of current law or the Hyde proposal. In fact, the CRS analysis to which Biden refers says that Schumer's amendment "is far broader in scope and would encompass a far wider range of potential debtor liability than is currently covered by [current law]." For example:

(a) *Injunctions:* Many clinic access debts accrue as a result of violations of injunctions. Such violations are strict liability offenses. If a court tells a protestor to stay away from a clinic, fines accrue for each day he or she protests without further inquiry into intent. The Schumer amendment would have made such debts nondischargeable.

(b) *State Clinic Access Laws:* Similarly, the Schumer amendment would have made nondischargeable debts under those State clinic protection laws that have no intent standard or one that is not as high as "willful and malicious."

(c) *Violations Meeting Only a Lower Standard for State of Mind:* The Schumer amendment also would have made nondischargeable judgements for "harassment of, intimidation of, interference with, obstruction of, [and] injury to" clinic health service providers. CRS concluded "the state of mind necessary to cause "interference" or "injury" may be short of the "willful and malicious" intention to cause injury or damage required under current law."

Political Environment: Abortion rights activists argue that Chairman Hyde, who testified as a character witness in a 1998 clinic violence trial, was adamantly opposed to the FACE Act from the outset. They believe he is working now with anti-abortion forces to let perpetrators escape liability for the very same types of acts that the FACE Act was intended to address. They view this as a major battle in the fight to preserve reproductive freedom.

4. **Balance in the Underlying Bill:** Senator Biden cites four provisions that are included in the final bill. Each is an important improvement over earlier versions, but none represents the balanced approach that your Administration sought for three years.

(a) *Protections for Low-Income Debtors:* The final bill includes a "safe harbor" that protects those under median income from motions by creditors alleging their use of Chapter 7 is abuse. It is not, however, complete protection from the means test. The below-median income debtors must still provide the detailed financial information on income and expenses and an analysis of their capacity to repay their debts. Moreover, U.S. bankruptcy trustees are required to scrutinize their capacity to repay under the means test. While the trustees believe that they will find few of these low-income debtors must be moved to Chapter 13, it is not the complete "safe harbor" from the means test that the Administration (and even Chairman Hyde) sought. Moreover, there are new filing and counseling requirements that apply to all debtors that are intended to create disincentives for debtors to file for bankruptcy.

(b) *Clearer Disclosure of the Terms of Credit Card Loans:* The disclosures required will tell a debtor that: "Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance." The disclosure also will include a generic example, although the numbers in the example will not relate to their individual circumstances. They also will be advised of an 800 number that they can call to find out how long it will take to repay their debt making only the minimum payment. We had supported a Durbin amendment that was included in the Senate bill from the previous Congress, which would have required the credit card company to calculate for each debtor not only the duration of payments but also what they would pay over time based on their particular situation. (For example: "If you make only the 2% minimum monthly payment on your balance of $____ [debtor's actual balance] at an interest rate of __% [debtor's actual interest rate] it would take __months to repay the balance in full and you would pay in total $____.") Creditors resisted calculating the precise period for each debtor, complaining about the programming costs, and fought any effort to have the debtor advised (even the few who will call the 800 number) of the total amount they would repay.

(c) ***Stronger Protections against Coercive Reaffirmations:*** The Administration did fight for and win inclusion of a new disclosure that all debtors must receive before they can reaffirm a debt. However, the form we proposed (used in about 10% of districts today) was rejected and a far less comprehensive form was substituted. Thus, while we won broader use of mandatory disclosures, we compromised significantly on the information provided. In addition, we had initially sought judicial scrutiny of all such reaffirmations; we eventually had to agree to scrutiny only of those where analysis suggests that the debtor has no capacity to repay the debt reaffirmed. Thus, courts may not find other debtors who are being coerced into reaffirming their debts, where the debtor has some limited capacity to repay but a legal right to discharge that debt. Moreover, to get any judicial scrutiny, we had to agree to language that consumer advocates believe will provide many new defenses to creditors whose collection practices are being challenged.

(d) ***Protection for Family Support Payments:*** In response to the First Lady's powerful arguments two years ago, this bill does contain provisions that should provide greater protection for child support and alimony in bankruptcy than does current law. However, she raised the issue because the bill made a wider class of credit card debts nondischargeable and those new nondischargeable debts would compete with child support and alimony. While child support and alimony is now largely although not completely protected), the new classes of nondischargeable credit card debts also survived (although somewhat narrower than initially proposed. Thus, for example, any debtor filing for bankruptcy will be unable to discharge credit card cash advances above $750 incurred in the final 70 days before bankruptcy, even if those advances were used to feed, clothe, or shelter a family juggling overwhelming debts. While the goal of the change is to target those who abuse the system by running up debts before a bankruptcy filing, it will actually reach many debtors innocent of such intent.

In addition to the provisions that Senator Biden mentions, there are other provisions in this bill that are a far cry from the provisions that we thought fairly balanced competing equities. For example:

(e) ***Judicial Discretion to Consider Individual Circumstances in Applying the Means Test:*** Under current law, a court can deny a person access to Chapter 7 discharge if they find that the debtor's filing constituted substantial abuse. The presumption is in favor of the debtor's filing. If it is abuse, the debtor must file under chapter 13 and repay what they can for 3 years. Under the final bill, if a debtor has the capacity to repay 25% of their debts or $10,000, which ever is lower, over 5 years, they must file under Chapter 13 and repay for 5 years before the remainder of their debt is discharged. Allowable expenses are determined by rigid allowances that specify how much one can spend for housing, food, clothing, transportation, etc. (The IRS previously developed these formula expenses to be used as "guidelines" – not caps -- for tax collection. Even Chairman Hyde agreed with us that we should develop bankruptcy specific standards.) The court can only vary from those allowances if they find "special circumstances that justify additional expenses with no reasonable alternative." The Administration had sought far greater judicial discretion to determine where abuse existed and where a person's existing pattern of spending was reasonable. For example, a debtor may choose to live in a more expensive area in order to be close to a family member who provides free and safe daycare for young children. However, the formula allowances will not pay for such high housing costs, but would pay for actual day care expenses. Thus, the rigid formula could have the unreasonable effect of forcing someone to move away from family to lower housing costs and put their children in unfamiliar, more expensive day care, and actually could result in less money available to repay creditors.

(f) ***Household Goods Protected from Creditor Seizure:*** Under current law, creditors who take a blanket lien in goods purchased with their credit (e.g., Sears) can seize or threaten to seize their collateral to compel repayment; however, debtors may avoid liens on, inter alia, "household goods." The final bill spells out precisely what goods one can protect from seizure. For example, it specifies one radio, one television, and one personal computer only if used primarily for the education or entertainment of minor children. It seems to many that such a precise list is unnecessary. A court can determine when a debtor wants to protect luxury goods and when they want to protect the reasonable contents of their family's home. But creditors argued that pro-debtor bankruptcy judges could not be trusted. We also argued that such goods rarely retain significant resale value. The primary reason for a creditor to threaten to seize such goods is to compel the debtor to find the resources to repay or to reaffirm a debt that otherwise they would be legally entitled to discharge. Consumer advocates fear that creditors will use the new limitation to intimidate debtors.

June __, 2000

Dear Mr. Speaker:

I write again because I am deeply concerned about recent developments concerning bankruptcy reform legislation pending before Congress. I understand the House and Senate Republican Leadership has reached a conclusion on a package they will soon move through the Congress. We have not seen the final language, but, if the verbal description is accurate, I will veto the bill.

OMB Director Lew sent a letter to the informal conferees, on May 12, 2000, that laid out the principles against which I will judge any final bankruptcy bill that comes to my desk. I would like to sign a balanced consumer bankruptcy bill that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. The majority of debtors turn to the bankruptcy system, not to escape bills they can afford to repay, but because they face hardship -- uninsured medical expenses, unemployment, or divorce. We can target the abuse without placing unnecessary barriers between a "fresh start" and those who turn to bankruptcy as a last resort. I remain concerned about the balance in the bill that the informal conferees have produced.

In addition, in my letter of June 9, 2000, I highlighted five issues -- then still unresolved -- that could help to determine whether the balance struck in the final bill meets my standards of balance and fairness. On three of these issues, the Republican resolution is seriously flawed.

First [and foremost] ***[Chuck wants it in, Larry wants it out]***, I cannot support a bankruptcy bill that fails to require accountability and responsibility from those who use violence, vandalism, intimidation, and harassment to deny others access to legal health services. Too many have strategically abused the bankruptcy system to avoid the penalties that Congress and the States have imposed for such illegal acts. The language that I understand the Republicans will include is inadequate to this task. It would require a finding that there was a "willful and malicious" threat of serious bodily injury before certain debts would be made nondischargeable. Often, no such finding is made when holding parties liable for their actions to deny others access to legal health services under Federal or State law. The final legislation must include an effective approach, such as the one contained in the amendment by Senator Schumer, which was passed the Senate by a vote of 80 – 17.

I am also concerned that the changes proposed to the Fair Debt Collection Practices Act would deny an effective remedy to victims of abusive check collection practices. We have yet to hear a compelling rationale for why check collectors should not be subject to the same requirements as those who collect other debts. No committee in either body of Congress ever considered this issue, raised for the first time in Conference. At a minimum, the proposal should be subject to full Congressional consideration, so that public scrutiny can be applied to the implications of the proposed changes.

The proposed limitation on state homestead exemptions will address, for the first time, those who move their residence shortly before bankruptcy to take advantage of large state exemptions to shield assets from their creditors. But the proposal does not address a more fundamental concern: unlimited homestead exemptions that allow wealthy debtors in some states to continue to live in lavish homes. Given how other provisions designed to stem abuse will affect moderate-income debtors, it seems unfair to leave this loophole for the wealthy in place.

I am satisfied that the agreement reached with Senator Kennedy on the pension issue, if included in the final bill, will appropriately protect retirement assets in bankruptcy while addressing any abuse that may exist. Similarly, the minor changes to the credit card disclosure provisions that have been described will not seriously threaten the ability of consumers to access important information that can help them understand the implications of the debt they are incurring.

I remain concerned, however, that the negotiations on other provisions have produced a bill that has lost some of the balance that the Senate bill had tried to achieve, albeit imperfectly from my perspective. As a result of all these concerns, I will veto the bill that we understand the Republicans plan to forward to my desk. But I continue to urge Congress to reconsider and send me a fair bill that meets the test of balance.

Sincerely,

WILLIAM J. CLINTON

United States Senate

WASHINGTON, D.C. 20510

June 23, 2000

Clinic Violence

Dear Colleague:

We are writing because of our very serious concerns regarding the Bankruptcy Reform Act (S. 625) conference. We are concerned that a key provision ensuring those who commit acts of clinic violence cannot discharge their debt through bankruptcy may be removed or weakened to the point of meaninglessness.

You may remember the notorious "Nuremberg Files" website which collected personal information about abortion providers, clinic staff, law enforcement officials, judges, and politicians. The site chillingly listed the names of those who had been wounded in grey type, and the names of those who had been murdered were crossed out. The site also included many Members of Congress. The FBI and the U.S. Marshal's Service advised the plaintiffs that these were serious threats to their lives and offered to provide 24-hour protection.

Just weeks ago, another defendant in the "Nuremberg Files" case, Joseph Foreman, filed for bankruptcy. Foreman was one of the 12 individuals and two anti-abortion groups ordered to pay more than $107 million as a result of their activities.

When the verdict was rendered, one of the "Nuremberg Files" defendants admitted: "Many of us have divested ourselves of assets in order they [pro-choice supporters] - they can't take them away." To date, six of the 12 individual "Nuremberg Files" defendants have filed for bankruptcy.

This latest development further highlights the essential importance of retaining the clinic-violence provision in its full strength in any final bankruptcy legislation. The Bankruptcy Code currently allows some perpetrators of clinic violence to discharge their debts. This provision would halt such evasions of the law.

We may have different views about abortion, but this issue is not about being pro-choice or pro-life. This issue is pro-law and pro-women's health. Preventing bankruptcy from being used to escape accountability for acts of clinic violence will strengthen the enforcement of the law, and will help vindicate the purposes of the Freedom of Access to Clinic Entrances Act.

Sincerely,

Patty Murray — Senator Patty Murray

Barbara A. Mikulski — Senator Barbara Mikulski

Mary L. Landrieu — Senator Mary Landrieu

GUIDANCE ON BANKRUPTCY
June 26, 2000

[Note: POTUS may send another letter this week. This guidance is good only until such letter is sent. This tries not to go beyond his last letter.]

Q: Senator Lott said that he would try to bring the bankruptcy bill to the floor of the Senate this week? Will the President sign that bill?

A: We are disturbed by recent developments on Capitol Hill regarding the bankruptcy bill. On June 9th, the President sent Congressional leaders a letter that noted (1) **concern with the balance struck in the underlying bill**, as well as (2) **concern about 5 "member-level" issues** then open. It appears that some of those may have been resolved, but that that the Republicans have decided to unilaterally resolve others.

We have seen no language and cannot be sure what they are planning, but if they move a bill as it has been reported, they will not have addressed the President's concern on at least 3 important issues:

- the **homestead** exemption;
- the proposed amendment to the **Fair Debt Collection Practices Act**; and
- abuse of bankruptcy by those seeking to avoid judgements for **clinic violence.**

The President's letter to Congressional leaders made clear that he hopes to be sent fair and balanced legislation, but ***he would "not hestitate to veto unfair legislation that fails the test of balance."***

Q: USA Today reports that the current bill contains a loophole that aids the rich? Is the President prepared to veto the bill because of the homestead provision?

A: The President shares the concern expressed by critics cited in the USA today story that the current provisions in the bill do not do enough to limit homestead exemptions.

In his June 9th letter to Congressional leaders, the President noted his concern that the current bill does "not adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from creditors."

Clearly, this issue is one of the key issues that the President will consider when he decides whether any bill sent to him by Congress meets the test of balance.

June __, 2000

Dear Mr. Speaker:

I write again because I am deeply concerned about recent developments concerning bankruptcy reform legislation pending before Congress. I understand the House and Senate Republican Leadership has reached a conclusion on a package they will soon move through the Congress. We have not seen the final language, but, if the verbal description is accurate, I will veto the bill.

OMB Director Lew sent a letter to the informal conferees, on May 12, 2000, that laid out the principles against which I will judge any final bankruptcy bill that comes to my desk. I would like to sign a balanced consumer bankruptcy bill that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. The majority of debtors turn to the bankruptcy system, not to escape bills they can afford to repay, but because they face hardship – uninsured medical expenses, unemployment, or divorce. We can target the abuses without placing unnecessary barriers before those who turn to bankruptcy as a last resort in need of a fresh start. I remain concerned about the balance in the bill that the informal conferees have produced.

In addition, in my letter of June 9, 2000, I highlighted five issues that could help to determine whether the final bill meets my standards of balance and fairness. On three of these issues, the Republican resolution is seriously flawed.

First, I cannot support a bankruptcy bill that fails to require accountability and responsibility from those who use violence, vandalism, intimidation, and harassment to deny others access to legal health services. Some have strategically abused the bankruptcy system to avoid the penalties that Congress and the States have imposed for such illegal acts. The language that I understand the Republicans will include on this subject is inadequate. It would require a finding that there was a "willful and malicious threat of serious bodily injury" before certain debts would be made nondischargeable. Often, no such finding is made when holding parties liable for their actions in denying others access to legal health services under Federal or State law. The final legislation must include an effective approach to this problem, such as the one contained in the amendment by Senator Schumer, which passed the Senate by a vote of 80 – 17.

I am also concerned that the changes proposed to the Fair Debt Collection Practices Act would deny an effective remedy to victims of abusive check collection practices. We have yet to hear a compelling rationale for why check collectors should not be subject to the same requirements as those who collect other debts. Moreover, no committee in either body of Congress has considered this issue, raised for the first time in Conference. At a minimum, the proposal should be subject to full Congressional consideration, so that public scrutiny can be applied to the implications of the proposed changes.

The proposed limitation on state homestead exemptions will address, for the first time, those who move their residence shortly before bankruptcy to take advantage of large state exemptions to shield assets from their creditors. But the proposal does not address a more fundamental concern: unlimited homestead exemptions that allow wealthy debtors in some states to continue to live in lavish homes. In light of how other provisions designed to stem abuse will affect moderate-income debtors, is it fair to leave this loophole for the wealthy in place?

I am satisfied that the agreement reached with Senator Kennedy on the pension issue, if included in the final bill, will appropriately protect retirement assets in bankruptcy while addressing any abuse that may exist. Similarly, the minor changes to the credit card disclosure provisions that have been described will not seriously threaten the ability of consumers to access important information that can help them understand the implications of the debt they are incurring.

I remain concerned, however, that the negotiations on other provisions have produced a bill that has lost some of the balance that the Senate bill had tried to achieve, albeit imperfectly from my perspective. As a result of all these concerns, I will veto the bill that we understand the Republicans plan to forward to my desk. But I continue to urge Congress to reconsider and send me a fair bill that meets the test of balance.

Sincerely,

WILLIAM J. CLINTON

June 22, 2000 -- Draft

MEMORANDUM TO THE PRESIDENT

CC: **JOHN PODESTA**

FROM: **GENE SPERLING**
CHARLES BRAIN

RE: **DECISION ON BANKRUPTCY REFORM LEGISLATION**

ISSUE PRESENTED:

Senator Lott has advised Senator Daschle that negotiations on bankruptcy reform legislation are over. The Republicans agreed to make some further concessions on a couple of the outstanding issues, but the final resolution fails to address three key concerns we noted in your recent letter to the Congressional leadership regarding the homestead exemption, discharge of penalties for violations of clinic access laws, and an exemption from the Fair Debt Collection Practices Act (FDCPA) for check collectors. These problems come on top of the dissatisfaction many of your advisors feel with the balance struck in the bill's other provisions.

Eleven Democratic Senators were opposed to the bill on relevant grounds when it passed the Senate. Senator Durbin, who led the bipartisan effort last year and voted for the Senate bill, has determined that the final bill is unacceptable to him, regardless of the outcome of these remaining issues. Senator Leahy, who voted for the Senate bill and has worked hard to ensure a fair process, believes that the clinic access and the check collector issue swing the balance against an already flawed product; he will vote against it in this form and recommend a veto. Senator Schumer, who strongly opposes the bill, believes that the clinic access issue will mobilize others. Senior staff to Senator Torricelli, the lead Democratic sponsor of the legislation, recommend that he oppose the bill unless there is some further compromise on clinic access. (We have been unable to confirm yet his personal view.) However, if clinic access is resolved, he would urge all Democrats to support the bill. Senator Biden, however, will support the bill in its current form regardless of the resolution of the clinic access issue.

Senator Daschle has asked about your intentions. He believes that, if you are clear that you intend to veto the bill now, we have some chance of keeping 34 Democratic Senators from supporting the final bill in its current form. If we do not signal any intention now and see what develops on the Hill, Daschle believes, momentum will build and the bill will pass by a veto-override margin. While he personally would support the bill in its current form, he would join you at least in opposing the clinic access and check collector provisions.

Your advisors unanimously recommend that you send another letter to the Congress that: (1) indicates that you will veto the bill that Lott described as final; (2) strongly implies that you will sign no bill without adequate clinic access provisions; (3) stresses your concerns with the current resolution of the check collector and homestead issues and the lack of balance in the remainder of the bill; but (4) leaves you room to decide how to proceed if the clinic access issue are resolved.

ADMINISTRATION APPROACH TO BANKRUPTCY REFORM

We have said repeatedly that you support balanced consumer bankruptcy that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. We can eliminate abuse without hurting those forced to turn to bankruptcy, the vast majority of whom are faced with some of the hardest circumstances that life has to offer – divorce, unemployment, illness, and uninsured medical expenses. Although we should not countenance people using bankruptcy to escape bills they can afford to repay, we also should not enact punitive legislation that places insurmountable barriers before the people who file for bankruptcy as a last resort.

To guide Congress in striking the proper balance, we have set forth principles that should be met by a final bill. Many of these issues were resolved on a bipartisan basis by Congressional staff. Others were reserved as "member issues." Just this week, Lott advised Daschle of the Republicans' final offer on these issues and their plan to move forward attaching bankruptcy to the next available vehicle.

ASSESSMENT OF NON-MEMBER ISSUES

In a letter to the informal conferees on May 12, 2000, Jack Lew set forth your key principles. A detailed assessment of the resolution of these issues is in the attached appendix.

In short, the final bill's provisions are closer to the Senate bill, than the House bill, but they do not incorporate the balance that you have sought. They reflect a compromise between a House bill that we thought badly one-sided and a better Senate bill about which we still had significant concerns. While all of your advisors believed when we wrote you on May 5th that you should sign a bill close to the Senate bill, this bill is a somewhat closer call.

For example, our fundamental concern about the rigidity of the means test in the Senate bill was not addressed. Moreover, changes were made from the Senate bill to shift a few more debtors out of Chapter 7 and limit a bit further the court's discretion to determine whether a debtor has the capacity to repay. Similarly, flawed language from the Senate bill narrowly limiting the family household goods that debtors can protect from creditor seizure was included in the final bill. While no one of these provisions alone merits your veto, cumulatively, they represent undesirable changes relative to the Senate bill.

ASSESSMENT OF RESOLUTION OF MEMBER ISSUES

You wrote to Congressional leaders on June 9th setting out your concerns about five open member issues. Our assessment of the resolution of these issues is below. In short, two issues of those have been resolved to our satisfaction (pension cap and credit card disclosures); one issue has been resolved to the satisfaction of key Senate Democrats but not to ours (homestead); and the Republican resolution of two issues (clinic access and check collector exemption) is unacceptable to the lead Democrats on those issues, although some Democrats would support the bill nonetheless.

Pensions: "The final bill may eliminate protections for reasonable retirement pensions that reflect years of contributions by workers and their employers."

The Senate bill included a noxious provision that would have allowed creditors to demand that debtors waive bankruptcy protection for pension assets as a condition of receiving credit. That was dropped in Conference, but Senator Grassley insisted on some limit on otherwise unlimited pension assets shielded from creditors. Senator Kennedy was deeply concerned that such a cap would send the wrong message about retirement savings. Moreover, seemingly large retirement accounts do not necessarily provide for extravagant lifestyles for workers with increasingly long life expectancies. A compromise was reached between Kennedy and Grassley that caps only certain IRAs, excluding amounts rolled over from employer pension plans, at $1 million. Moreover, the court has discretion to waive the cap in the interests of justice. ***This resolution seems reasonable and consistent with our arguments in the homestead context.***

Credit Card Disclosures: "The final bill may weaken important credit card disclosure provisions that will help ensure consumers understand the implications of the debt they are incurring."

The Senate bill requires modest new credit card disclosures. Consumers would be given better information about credit card "teaser rates" and the impact of making only the minimum payment on the length of time one would be repaying debt. Your letter referred to an effort by Senator Gramm to exclude small banks from the provisions' scope. However, the provisions survived without the exclusion, although for two year the Federal Reserve Board will be asked to provide consumers with an 800 number for information about credit cards issued by smaller banks – an 800 number that larger banks will have to provide themselves. ***The Senate bill's modest disclosure requirements have been effectively preserved.***

Homestead: "The final bill may not adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from their creditors."

State law allows debtors to exempt from the bankruptcy estate home equity valued up to specified homestead exemption thresholds. Five states (including Texas and Florida) have unlimited homestead exemptions, effectively allowing wealthy debtors to shield millions in assets in valuable mansions, while avoid repayment of their creditors. It seems to us fundamentally unfair to ask low- and moderate-income debtors to devote future income to repay all the debts that they can, while leaving loopholes that allow the wealthy to shield assets from their creditors. The final bill has a modest limitation on unlimited homesteads, in that debtors must have had the equity in the home for two years prior to the bankruptcy filing. ***This does not address our fundamental issue.*** Moreover, wealthy debtors often can use bankruptcy planning to postpone bankruptcy for two years while they qualify for the unlimited homestead exemption.

Senator Kohl, the Democratic Senate champion of this issue, is satisfied that this resolution represents a good first step and establishes the principle that some nationwide limitation on homestead exemptions is appropriate. (Kohl is undecided whether he will support or oppose the overall bill.) Senator Leahy does not want to flank Senator Kohl on the left on this issue. Thus, if you take this issue to the public, you will have only long-time bankruptcy bill opponents like Wellstone, Kennedy, and Nadler joining you from Congress. However, many editorial pages around the country have pressed this issue hard and would applaud your concern.

Fair Debt Collection Practices Act: "The final bill may include an anti-consumer provision eliminating existing law protections against inappropriate collection practices when collecting from people who bounce a check."

In conference, Senator Hatch has insisted on an anti-consumer provision (in neither the House or Senate bills) which would eliminate attorneys fee awards for violations of the Fair Debt Collection Practices Act, if the defendant is collecting bounced checks rather than other defaulted debt. This is a pernicious provision because it could give check collectors de facto rein to intimidate and harass lower-income debtors, knowing that their financial position would prevent them from hiring counsel. Often, the only effective enforcement of the check collector provisions is class action litigation, financed by firms because of the potential for attorneys fee awards. Senator Torricelli suggested a minor change, which the Republicans accepted, that limits attorneys' fees to cases where the debtor can prove that he or she had no intent to defraud. Senators Leahy and Sarbanes argue that such a standard is impossible to prove. ***Our fundamental concerns have not been addressed.***

Clinic Access: "Some in Congress still object to a reasonable provision that would end demonstrated abuse of the bankruptcy system. We cannot tolerate abusive bankruptcy filings to avoid the legal consequences of violence, vandalism, and harassment used to deny access to legal health services."

The Senate bill included a Schumer amendment to address the announced strategy of anti-abortion protestors using bankruptcy to avoid penalties for violence against family planning clinics in violation of the Freedom of Access to Clinic Entrances Act (FACE) and its state counterparts. We strongly supported the amendment. The Vice President was in the Senate chamber when they voted to break a tie, if needed. To avoid embarrassment, the Republicans ensured that the amendment passed by a vote of 80-17. However, in conference, they have steadfastly refused to include it or a comparable measure. Their alternative, which they have unilaterally announced will be in the final bill, does little beyond current law. It precludes discharge of all judgements for acts of violence where behavior was shown to be willful and malicious. Advocacy groups argue that few of the actual judgements against, or settlements reached with, defendants who harassed clinic patients include a finding of willful and malicious behavior. Moreover, harassment and intimidation does not always include violence. ***Thus, the final unilateral resolution does not satisfy our concerns.***

This is the hardest issue for the Democrats who want to support the bill. Abortion rights groups are energized. If you take a strong position, this is the issue most likely to rally Democrats in opposition to the bill. Even Senator Torricelli is expected to oppose the bill if further changes are not made to this provision, although Senator Biden does not believe this issue should bring down the entire bill.

STATUS IN CONGRESS

It will not be an easy task to convince 34 Senators to oppose the bill. Senator Daschle has conducted a preliminary whip count. While many are still undecided and few any substantive knowledge of the bill's final provisions, Daschle's office conclude it will be very difficult to obtain a veto sustaining margin. Although there are reports that some Senators are rethinking their positions on the bill in its current form, Senators Durbin and Leahy are the only Senators who voted for the bill on the floor to publicly announce that they will now oppose the measure. Nonetheless, Senators Schumer, Kennedy, and others believe that the clinic violence amendment is salient enough, and has sufficient support from the women's and choice groups, that a critical mass will rally around this issue and vote against the bill if you lead the way. In addition, Senators Leahy and Sarbanes strongly oppose the Hatch check collector amendment and plan to use it to try to unite Democrats in opposition.

Senator Daschle's staff report that their boss is inclined to support the bill in its current form. The Minority Leader would likely stand with you in opposition to the bill, however, if you make an early and clear statement of your intent to veto the measure in its current form. As noted above, Senator Leahy will oppose the bill with the flawed clinic violence provision and recommend that you veto the measure. Senator Torricelli's staff believe he will as well. Those two lead Democratic negotiators would be joined by a group of roughly 12 Democrats, led by Senators Kennedy, Durbin, Schumer, Feingold, and Wellstone, who will oppose the bill in whatever form it is presented to them. On the other hand, there is a group of five to seven Democrats, led by Senators Biden, Johnson, Breaux, and Reid of Nevada, who will likely support the bill in whatever form it is presented to them. Senator Jeffords is the only Republican who has publicly noted some concerns with the measure.

There is little prospect for overcoming the strong veto-proof margin of 313 to 108 by which the House passed its bill last May. Moreover, you can expect that the Republicans will send whatever vehicle they use for the bankruptcy bill to the House first to try to gather momentum.

RECOMMENDATION

Your advisors unanimously recommend that you send another letter indicating that the Republicans "final" bankruptcy bill is one that you would veto. The letter would note that there has been an acceptable resolution on pensions and credit card disclosures, but that you have continuing concerns about the check collector, homestead, and clinic access provisions. Special emphasis will be given to the clinic access issue, so that no one reading the letter would doubt you would veto any bill without its satisfactory resolution. A reader should also be concerned that you might veto a bill that does not resolve the homestead and check collection issues to your satisfaction, but the letter will give you sufficient latitude to make that decision later. There is a real risk that Congress could resolve the clinic access issue, leaving you with only a handful of Democratic Senators joining you in opposition to a bill with the other provisions.

DECISION

___ **1. Send the letter as proposed**

___ **2. Let's discuss**

APPENDIX
ASSESSMENT OF UNDERLYING BILL'S BANKRUPTCY PROVISIONS

In a letter to the informal conferees on May 12, 2000, Jack Lew set forth your key principles. Our assessment of the resolution of these issues is below.

Means Test: "Access to Chapter 7 should not be governed by an arbitrary means test, but by reasonable guidelines that take into account individual circumstances."

We have argued unsuccessfully that various changes are needed to build more discretion into the system to determine whether, in the debtor's individual circumstances, they really have the capacity to repay. We have also sought less stringent thresholds and various technical changes to prevent unfairness in the application of the test. We did succeed in preventing creditors from filing motions to challenge low-income debtors' bankruptcy filings, but these below-median income debtors will be subject to the burdens of new means test paperwork and trustee scrutiny even though only a tiny fraction will have any capacity to repay their debts. While some modest improvements were made in conference, ***the final bill (like both House and Senate bills) does not address many of our fundamental concerns.***

Protection Against Coercive Reaffirmations and Practices: "There must be appropriate safeguards against coercive creditor practices that compel debtors to forgo their rights and that disadvantage more scrupulous creditors."

During bankruptcy, too many debtors are misled or deceived into agreeing to repay debts that they cannot afford and have a legal right to discharge. The final bill contains provisions, based on an Administration proposal, that make it significantly more difficult to mislead or deceive debtors who cannot afford to reaffirm their debts. To get our proposal included in the Senate, we had to make some significant compromises with the credit card industry that cause consumer advocates concern. We sought further improvements in conference but they were not made. However, truly offensive provisions from the House bill (that would have banned class actions as a remedy for existing law violations) were dropped. As a whole, your staff believe ***these provisions are a net improvement for consumers over current law***.

Improving Credit Card Practices: "Both debtors and creditors must be required to be responsible. Bankruptcy reform should be balanced by including provisions that address credit-card practices that may lead to bankruptcies."

As discussed in the body of the memorandum, modest new credit card disclosure requirements were included in the Senate. These largely survived in tact in the final bill. Consumers are given better information about credit card "teaser rates" and the impact of making only the minimum payment on the length of time one would be repaying debt. ***Overall, while we believe more information could be provided more clearly, these provisions are an improvement over current law.***

Non-dischargeable Debts and "Cram Downs": "The goal of repaying creditors must be balanced with the need to protect social priorities, such as payment of child support, alimony, and taxes, and to preserve a meaningful opportunity for a fresh start."

In the last Congress, the First Lady wrote of her concern with provisions that make additional credit card debt nondischargeable in bankruptcy, thus leaving it to compete with higher societal priorities that also are nondischargeable – especially payment of child support and alimony. In response, the bill's proponents left the new categories of nondischargeable credit card debt, albeit somewhat narrower, but added provisions to clarify that child support and alimony are the highest priority. These provisions will work in many cases to improve the payment of child support and alimony in bankruptcy; however, in a small portion of cases after bankruptcy discharge, these new nondischargeable credit card debts could crowd out child support or alimony. Our argument is very technical, however. ***Rhetorically, they have neutralized our child support and alimony criticism.***

We have a similar concern about provisions in the final bill that would give secured creditors unprecedented rights to collect amounts in excess of the value of their collateral. (Current laws "crams down" their claim to the value of the security. Thus, if a car is worth less than the amount originally borrowed, the claim is limited to the car's value.) Since secured debt must be satisfied if the collateral is to be kept, collection of other societal priorities (like child support, alimony, and taxes) might also suffer a bit. The bill also skews the distribution of scarce debtor assets toward undersecured creditors instead of unsecured creditors (like credit card companies). The latter firms support is ironic, but this was a political bargain they made with car financing firms to win Senator Abraham's support. While the final bill is better than the House provisions, ***our fundamental concern was not addressed.***

Barriers to Entry or Representation in the Bankruptcy System: "Inappropriate barriers should not be created to entry into or effective representation in the bankruptcy system."

The Administration has been concerned about inflexible pre-bankruptcy filing hurdles, including paperwork and counseling requirements and fees. We were also concerned about attestation requirements and sanction provisions that could deter attorneys from representing debtors or raise the costs of representation. The final bill waives fees for low-income debtors, reduces some of the paperwork requirements, and eliminates the most chilling requirements for debtors' attorneys. ***While hardly the provisions we would have written, we do not have strong objections to the remaining provisions.***

Ann O'Leary
06/09/2000 11:32:38 AM

Record Type: Record

To: Ruby Shamir/WHO/EOP@EOP

cc:
Subject: URGENT FOR GENE RE BANKRUPTCY LETTER

melanne and i should talk about this as soon as we get off the phone.

---------------------- Forwarded by Ann O'Leary/OPD/EOP on 06/09/2000 11:32 AM ---------------------------

Sarah Rosen Wartell
06/09/2000 11:28:22 AM

Record Type: Record

To: Ann O'Leary/OPD/EOP@EOP

cc:
Subject: URGENT FOR GENE RE BANKRUPTCY LETTER

---------------------- Forwarded by Sarah Rosen Wartell/OPD/EOP on 06/09/2000 11:28 AM ---------------------------

Sarah Rosen Wartell
06/09/2000 11:20:47 AM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:
Subject: URGENT FOR GENE RE BANKRUPTCY LETTER

Gene asked me to revise this letter and get it to him. If it is okay with him, it is to go to Karen Tramontano who will try to read it to Podesta. Find out if he wants to read it himself again or just send it on, but get his guidance before noon. He wanted it to go.

This reflects comments or clearance from WH Leg (Wiginton), OMB (Deich and Minarik), Treasury (Summers, Eiszenstat, and Elmendorf), DoL (on pension issue -- Kramerich), DoJ (Posner). Have not been able to reach O'Leary in the first lady's office. Also reflects attempt to address comments Gene passed on this morning from staff meeting.

Draft -- June 9, 2000

The Honorable Trent Lott
Majority Leader
United States Senate

Dear Mr. Majority Leader:

I write to urge a fair resolution of the open issues in discussions on bankruptcy reform. I have long made clear my support for legislation that would encourage responsibility and reduce abuses of the bankruptcy system on the part of debtors and creditors alike. We also must ensure that a reasonable fresh start is available for those who turn to bankruptcy as a last resort when facing divorce, unemployment, illness, and uninsured medical expenses. Bankruptcy reform legislation should strike the right balance.

The House-passed bill was so one-sided that I would have vetoed it. The Senate-passed bill's bankruptcy provisions represented a bipartisan attempt to balance legitimate debtor and creditor interests, although I had serious concerns about some aspects. My Administration has watched carefully as the informal conferees have sought to reconcile these two bills. We have been disappointed, as compromise has resulted in changes that, bit by bit, erode protections for <u>all</u> debtors – not simply those few who abuse the system. There remain a number of key issues not yet clearly resolved. While there may have been some informal progress on these issues, it is very important that the resolution of these issues be fair. Their outcome will help determine whether the final bill tips the scales.

I am concerned, for example, that the final bill:

- may not adequately address the problem of wealthy debtors who use overly broad homestead exemptions to shield assets from their creditors;
- may weaken important credit card disclosure provisions that will help ensure consumers understand the implications of the debt they are incurring;
- may eliminate protections for reasonable retirement pensions that reflect years of contributions by workers and their employers; and
- may include an anti-consumer provision eliminating existing law protections against inappropriate collection practices when collecting from people who bounce a check.

Finally, I am deeply disturbed that some in Congress still object to a reasonable provision that would end demonstrated abuse of the bankruptcy system. We cannot tolerate abusive bankruptcy filings to avoid the legal consequences of violence, vandalism, and harassment used to deny access to legal health services. Senator Schumer's amendment should be included in the final legislation.

I sincerely hope that balanced, bipartisan bankruptcy reform will be completed this year, but I will not hesitate to veto unfair legislation that fails the test of balance.

Sincerely,

William Jefferson Clinton

IDENTICAL LETTERS TO DASCHLE, HASTERT, AND GEPHARDT

Ann O'Leary
07/20/2000 10:55:47 AM

Record Type: Record

To: Ruby Shamir/WHO/EOP@EOP

cc:

Subject: Bankruptcy Update -- HIGHLY ~~CONFIDENTIAL~~

DETERMINED TO BE AN ADMINSTRATIVE MARKING Per E.O. 12958 as amended, Sec. 3.3 (c)
Initials: RLCR Date 10/07/14

Please share with Melanne.

---------------------- Forwarded by Ann O'Leary/OPD/EOP on 07/20/2000 10:55 AM ---------------------------

Sarah Rosen Wartell
07/20/2000 10:20:15 AM

Record Type: Record

To: Michael Deich/OMB/EOP@EOP, Andrew Abrams/OMB/EOP@EOP, Alan B. Rhinesmith/OMB/EOP@EOP, Joseph J. Minarik/OMB/EOP@EOP

cc: douglas.elmendorf@do.treas.gov, Ann O'Leary/OPD/EOP@EOP, Joel K. Wiginton/WHO/EOP@EOP

Subject: Bankruptcy Update -- HIGHLY ~~CONFIDENTIAL~~

Per Michael's request, here is a status report, but please treat as very sensitive.

As you know, Lott called the President and said -- in short -- you've said what you won't sign, tell us what you will sign. He urged POTUS to send Gene to hill "with language" to discuss.

So after various delays, Gene, Chuck, Joel W. and I met with Lott staff. (As I feared, they also brought Hatch and Grassley staff -- so the Dems were pissed.)

Gene was pretty clear -- our view is the inverse of what our letter said.

Fair Debt Collection Practices -- This amendment should not be included. Despite press reports that Hatch will drop it, they made a feeble attempt to defend it -- but I suspect largely as a negotiating tactic. If everything else were resolved, I suspect it would be gone.

Homestead -- We gave them language that includes what Senator Kohl has already negotiated with them (pocketing the deal that you can't add more than $100,000 in equity to a home or move to a new home in a new state within 2 years of bankrutpcy -- except that you can carry the equity you had in your old home in the old state to the new home in the new state) plus we added an absolute cap of $250,000 on state homestead exemptions. We suggested that number wasn't written in stone but indicated the zone that we thought it should be.

Clinic Access -- We essentially gave them a recent draft that Schumer had floated not so long ago (although only hours after he floated it, the Republicans announced they were going with their current langauge -- so this was never really considered). Only change we made was that the Schumer language said: "debts arising from judgements or settlements, etc. resulting from alleged or other violations of law, including the FACE act, that ....." We deleted "including the FACE act" as unnecessary. schumer had previously dropped all references to "reproductive health services" and made the references only to "health services." Thus, it is left with no reference to abortion. They wanted to focus the debate on whether this should be about intimidation, harassment, etc. because the person was obtaining or providing health services (schumer) or legally available products or services (republicans). The later grossly expands nondischargeable debt, infuriates the abortion groups, and most of all -- is seen as a hostile act by organized labor because Republicans spin it as a way to deal with union violence. If that were all that were separating us, it might be a tough choice for us but it is not the only difference. They insist on a "willful and malicious" standard that the supreme court has said is VERY high -- means you must show intention to cause that injury. So Gene turned the tables and said -- "so you are saying the rest of the Schumer formulation is okay????" They said they had to get back to us. It clearly won't be to Hyde, etc.

Gene also said that the President does not believe the underlying bill is balanced and is no fan of the bill. Gene said he couldn't say that we might not be a bit more flexible about these issues if they would have addressed many of our concerns with the underlying bill. Rumor is the Rs have seized on that and are proposing changes to the underlying bill in hopes we'll back off on Schumer (where they can't get Hyde to budge). Leahy's folks got mad that we left the impression that we'd abandon Schumer - although that is clearly not what Gene said.

But in short, we're waiting to hear back from them. Hatch staff did hand Gene a letter from Hatch to Schumer making a bunch of weak arguments about why Schumer isn't needed and asked for an Administraiton reply. We're not sure there is any advantage to us doing so, as Schumer and NARAL are both replying.

4-13-99

Copied
Sperling
Stein
Verveer
Podesta

THE WHITE HOUSE
WASHINGTON

April 13, 1999

MR. PRESIDENT:

This is a long memo from Gene/Larry/Melanne on bankruptcy reform issues and strategy. In short, it says that absent a strong push by the Administration, you may well receive veto-proof legislation in the next few weeks that you won't want to sign. They recommend the following strategy:

(1) Publicly Criticize the Bad Parts of the Legislation -- present sympathetic debtors who'd be denied a fresh start; highlight permitted abusive and coercive debt collection practices; point out the lack of greater credit card disclosure requirements; reveal the lingering threat to child support/alimony collection (this years' bills are improved somewhat in this regard); and expose the loopholes for lavish homestead exemptions (see pp. 3-7 for details on these issues);

(2) Advance Alternative Provisions -- work with the bills' proponents (Sens. Torricelli, Grassley) to find acceptable improvements (*e.g.,* by addressing creditors' concerns with the discretion we want courts to have);

(3) Work with Sens. Durbin, Kennedy, Leahy -- Durbin and Kennedy may be willing to lead the caucus (if Torricelli does not) and help develop a Senate floor strategy that would include amendments to increase our leverage; and

(4) Work with Key House Members -- engage Rep. Gephardt and work with Reps. Nadler/Conyers, possibly Frank, to improve the House bill or try to produce the 20-25 votes necessary to sustain a possible veto.

Approve Approach ✓ Disapprove ___ Discuss ___

Phil Caplan Phil
Sean Maloney SPM

THE PRESIDENT HAS SEEN
4-13-99

'99 APR 6 PM 9:32

THE WHITE HOUSE

WASHINGTON

April 6, 1999

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING
LARRY STEIN
MELANNE VERVEER

RE: BANKRUPTCY REFORM STRATEGY

ACTION FORCING EVENT: Bankruptcy legislation is moving rapidly through the House and the Senate. Both chambers plan to complete committee action after recess and take floor action in May. Last year, we worked closely with Senator Durbin, resulting in a 97-1 Senate vote for a moderate and balanced bill. The moderating provisions were largely abandoned in Conference. Your advisors informed Congress that they would recommend a veto of the Conference Report. The Senate never voted on the Conference Report, because Senator Durbin threatened delay and because pro-reform lobbyists --predicting Republican gains in the 1998 elections --decided to wait to reintroduce the legislation in this Congress. If the Senate had voted on the Conference Report, we do not know what the outcome would have been. The House approved the Conference Report by a veto-proof vote of 300-125. Minority Leader Gephardt was among the 80 or so Democrats supporting the Conference Report.

This year, while Congressman Nadler is leading efforts against the Conference Report and working to enlist greater support for a more moderate approach. Nonetheless, we expect the House to approve a bill like the Conference Report by a similar margin. In the Senate, there seems to be less support than previously among Democrats for fighting unbalanced legislation. Absent a strong effort by the Administration to influence the legislation, it is likely that you will be presented legislation that you will not want to sign, but which may have sufficient support to override a veto.

RECOMMENDATION: We seek your approval of a strategy designed to increase our leverage and reduce the likelihood of a veto override. Specifically, we seek authority to: (1) exploit publicly the vulnerabilities of the legislation (by presenting sympathetic scenarios of debtors denied access to a fresh start under the bill, attacking provisions in the bill that roll back existing protections against abusive and coercive collection practices, highlighting the bill's failure to improve disclosure and stem credit card abuses, and critiquing lingering danger it presents to child support and alimony collection); (2) work with bill proponents and opponents (including Senators Torricelli and Grassley and Representative Nadler) to advance alternative provisions that would substantively improve the current bills; (3) work with Senators Durbin, Kennedy, Leahy and others to develop a Senate floor strategy and identify message amendments which could motivate Republicans to compromise; and (4) work with Representatives Nadler, Conyers, Frank, Gephardt, and Bonior to produce a more palatable House bill, or, if that is not possible, to garner the 20-25 additional House votes necessary to sustain your veto.

THE STATUS OF BANKRUPTCY LEGISLATION IN CONGRESS: In the House, Representative Gekas, introduced H.R. 833, which is virtually identical to last year's Conference Report. It now has 93 cosponsors, including nearly 40 Democrats (*e.g.*, Representatives Boucher, Frost, Kennedy, Holden, Menendez, Roemer, Maloney, and Velazquez). Minority Leader Gephardt supported the Conference Report last year, and would likely do so again (albeit with a low profile). However, if a strong balanced alternative can be constructed that has the strong public backing of the White House, Gephardt might be willing to rally his caucus vigorously around such a vehicle.

Representatives Conyers and Nadler recently wrote to you praising you and the First lady for your leadership last year and asking you to reiterate your opposition to last year's Conference Report. On March 23, 1999, Jack Lew sent a reply noting that your senior advisors had recommended a veto of the Conference Report last year and that "our position . . . has not changed." Armed with that letter and an alternative bill being developed by a group of bankruptcy experts at the National Bankruptcy Conference, Representative Nadler is confident (perhaps more than we are) that he can prevent some Democrats, who last year supported the Conference Report, from doing so this year. Achieving this goal is critical to a credible veto threat.

In the Senate, we originally hoped that Senator Torricelli would not co-sponsor Senator Grassley's bill (which is modeled after the Conference Report) demonstrating to other Democrats that the bill was not ready for the caucus' support. Unfortunately, Senator Torricelli did agree to cosponsor S. 625, although extracted some moderating changes as a precondition of his sponsorship. He also wrote a letter to Senator Grassley outlining six areas where the bill needs to be improved before it leaves the Senate. Although we would like to see some other changes as well, we largely agree with the six areas that Torricelli outlined. (The First Lady urged Senator Torricelli to hold firm on these issues.) We are skeptical, however, that the Republicans will accept many of these amendments either in committee or on the floor. Even if they did, as last year, we can expect any progress made to be undone in conference with the House.

Senator Grassley is more reasonable on bankruptcy than many Republicans, but we do not believe that he will be able to hold off his colleagues who believe they can get Democratic support without further compromise. Senator Biden is already a co-sponsor and five or six other Democrats have expressed interest in signing on the bill. Senator Leahy also may support the bill in Committee as a demonstration of support for Senator Torricelli, who replaced Senator Durbin as ranking member on the relevant subcommittee. Many signs suggest that Senator Torricelli will not oppose the bill even if the additional changes he seeks are not made. Senator Daschle, who wants a bankruptcy reform bill, will likely support S. 625 in the end if enough Democrats move in that direction. Well positioned Democratic staff believe there may be enough votes in the Senate to override a Presidential veto. Finally, last year, Banking Committee Chairman D'Amato raised no objection to provisions inserted on the Senate floor that required credit card companies to provide greater disclosure to consumers.

These provisions were important to our support of the Senate bill. However, the new Banking Committee Chairman, Senator Gramm, recently noted his opposition to any bankruptcy bill which contains the credit card protections that we view as important. Senator Gramm has reportedly said that a bill with these consumer protections "will pass over [his] dead body."

At this time, neither the Administration nor effective advocates like Senator Kennedy have mounted any offensive. Thus, our assessment is preliminary and we hope to affect it. Some House and Senate Democrats are looking to the White House for political guidance and leadership on this issue. While they want to support bankruptcy legislation, we should be able to keep them from supporting the bills moving in each chamber if we give them a viable alternative and a strong rationale not to do so.

RECOMMENDED STRATEGY: While we believe that the current bills before Congress are sufficiently flawed as to merit continued opposition, we also believe that bankruptcy reform is not only desirable but necessary. Our goal is to gain sufficient leverage in the debate on Capitol Hill to make modest but important changes to the bills, so that we could recommend that you sign the resultant legislation. We recommend the four-prong strategy described below.

1. <u>Exploit Vulnerabilities</u>

It is difficult to rally Members or the public around complicated technical issues like nondischargeable debt and means test formulas. However, there are messages we can use to address each of our major areas of concern.

A. The Formulaic Means Test Will Block Efforts of Responsible Debtors to Get Back on Their Feet

One of our most significant concerns with the current bill is that the procedures established do not afford debtors a meaningful opportunity to have their specific circumstances evaluated and do not give the court the necessary discretion to take those circumstances into consideration. While it is difficult to defend judicial discretion, we can tell stories about sympathetic debtors who would be caught by the bill's rigid approach.

Under the bill, the bankruptcy trustee would determine whether a debtor can afford to repay some of their debts by considering the debtor's income, less certain standard allowances for food, clothing, transportation, and housing expenses rather than what the debtor actually spends for those items. There may be cases where the actual expenses are above the allowance amount for good reason, but the court can only provide an exception if the debtor meets the burden of proving that their circumstances "exceptional" and the additional expenses "necessary."

So, for example:

- No exception likely would be made for a debtor who helped his non-dependent mother meet her expenses so that she could live on her own and stay out of a nursing home. That debtor could be denied access to Chapter 7's "fresh start" and the funds used to pay for his mother's housing expenses would instead go to pay off his credit cards.

- Similar problems arise especially in ethic and lower-income communities where neighbors, friends, and relatives often bear significant costs to help children, elderly, the disabled, the unemployed, and others who are not legally their dependants.

- No allowance likely would be made if a debtor's transportation expenses to get to work on the other side of town are above the area allowance. The choice posed could be stark: (1) find a job closer to home (even if less likely to provide career advancement) to lower transportation costs and free up money to repay your creditors; or (2) fail to feed or cloth your children.

- No allowance likely would be made if the debtor's rental costs are higher than the area allowance, even though her apartment allows her to live near to a relative who can safely watch the children after school. The current test could force that single mother to move her family from her home without an opportunity for individualized assessment of the tradeoffs.

In addition to these scenarios, we can make much of the false representation made by bill proponents that the bill no longer would impact below-median income debtors (who make up 80% of those in bankruptcy). All debtors would be subject to the new mean test; while creditors could only bring "abuse" motions against above-median income debtors, the bankruptcy courts and trustees would be required to apply the means test to all debtors.

B. The Bills Roll Back Existing Protections Against Abusive Collection Practices and Coercion.

In a famous, recent case, Sears was found to have harassed creditors into agreeing to repay debts that they no longer had -- having been discharged in bankruptcy. The court found that Sears had violated the "discharge injunction" and was liable for millions of dollars in damages to hundreds of thousands of debtors. Under the House bill, creditors could harass debtors to repay discharged debt with little fear of consequences, as class actions and punitive damages -- the tools that brought the Sears' practices to an end -- would be barred.

Another concern is the bill's failure to deal with coerced reaffirmations of debt. Thousands of bankruptcy debtors each year agree to "reaffirm" one or more debts -- agreeing to pay it back even though they have the right to have the debt discharged in bankruptcy. We have no objection to letting debtors make an informed choice about whether to repay debts. There is widespread evidence, however, that debtors' decisions are not informed and that creditors coerce debtors into reaffirming debts by threatening to challenge the bankruptcy proceedings if they do not reaffirm, promising new credit lines in exchange for reaffirmation, and harassing collection efforts aimed at debtors ignorant of their rights. Provisions of these bills will create new opportunities for creditors to threaten and harass debtors.

In numerous cases, debtors "agree" to reaffirm debts even though they do not have sufficient income to pay their current expenses. While some may be optimistic, many more feel they have no choice when approached by a creditor threatening to challenge their bankruptcy. It would not be unusual to see a reaffirmation agreement, for example, where the debtor agrees to repay $1000 in order to get a $500 line of credit -- an effective interest rate of 200% on the new debt, even though far less expensive credit lines are now available even for those currently in bankruptcy. Even where a debtor makes an informed choice, ***reaffirming the debt may harm ex-spouses and children whose child support and alimony may not get paid because the reaffirmed debt is paid instead.***

The Bankruptcy Review Commission concluded that reaffirmations of unsecured debt should be banned outright. We proposed instead a "coercion" check -- a review by the bankruptcy court of any reaffirmation of unsecured debt to ensure that it was an informed choice in the best interest of the debtor and others. We will press this issue more visibly this year, while developing compromise alternatives that we could offer in final negotiations.

C. Consumer's Right-to-Know and Protection from Credit Card Abuse

Consumers are well aware of intense and misleading credit card marketing efforts. Last year's Senate bill contained a number of important credit card provisions including: (1) a requirement that credit card companies disclose on monthly statements how long it would take (and how much it would cost) to pay back the debt, if consumers only made the minimum payment; (2) a requirement that consumers be notified when credit card companies or retailers take a security interest in the goods purchased; and (3) a requirement that credit card companies inform debtors that they have not assessed the debtors' capacity to repay additional debt and provide a worksheet so that the debtor can easily make that calculation for themselves. These provisions were stripped in conference, leaving only a requirement for the Federal Reserve to study what further disclosures would be helpful.

Senator Sarbanes and other Democrats have introduced legislation separate from the bankruptcy bill that incorporates many of these consumer education provisions. In addition, Representative LaFalce and Senator Schumer have introduced bills that contain a host of additional credit card protections, many of which the Administration supports. One, for example, would eliminate the misleading advertising of credit card "teaser" rates -- which leave consumers shocked by dramatic interest rate increases when rates expire or they incur a penalty for a minor late payment. You are scheduled to unveil a consumer financial protection package the week that Congress returns, which includes many of these credit card provisions, as well as privacy protections. At that time, you can praise the efforts of Democrats in both chambers to protect consumers against abusive credit card practices. While we will not make passage of any *specific* credit card provisions a precondition for bankruptcy support, some balance in this regard is essential. By raising the profile of credit card issues, you will increase the leverage of Democrats seeking to incorporate some of these provisions in the bankruptcy bill and give Democrats an issue around which they can rally.

D. Child Support and Alimony Collection

The bankruptcy bills create or expand categories of nondischargeable debts -- i.e., debts that can be collected after bankruptcy. Last year we argued that these new nondischargeable debts would impair the collection of child support and alimony. In response, the bills' proponents both narrowed the categories of new nondischargeable debts and added a host of provisions that genuinely make it easier for former spouses and custodial parents to collect child support and alimony from debtors in bankruptcy. As a result, the bills probably improve the collection of family support obligations more than it is harmed. However, the bills have not been entirely corrected in this regard. We can continue, therefore, to argue credibly that child support and alimony collection is harmed *in some cases*. In particular, two concerns remain:

(1) the bills now provide that, in the supervised context of a bankruptcy plan, child support and alimony payments must be given the highest priority. However, under these bills, some debtors will have obligations to repay reaffirmed or newly nondischargeable debt. After the bankruptcy discharge, there is no court supervision or other mechanism to ensure that child support and alimony are paid first. The custodial parent or former spouse is unlikely to be as effective as the card company in collecting payment. Once these lower-priority payments are made, it is not practical to require the custodial parent or former spouse to go after the creditor to assert a claim on those payments.

(2) the bills also raise another concern for the payment of child support and alimony. If debtors are forced into Chapter 13 who do not genuinely have the capacity to repay -- as we fear will occur under the current versions of the means test -- they will eventually return to Chapter 7 with a diminished ability to repay their nondischargeable debts -- in particular their child support and alimony -- because while under the plan, they devoted some of their assets to paying their other creditors.

E. The Bills Leave in Place Huge Loopholes for Wealthy Homeowners While Squeezing Low and Moderate Income Debtors in over Their Heads.

Some of the most famous cases of abuse involve celebrities who file for bankruptcy and walk away from most of their debts but continue to live in multimillion dollar mansions protected by "homestead exemptions." (State exemptions also protect such luxuries as race horses and silver spoons in Virginia.)

Yet, at the same time we are creating a system that will ask low and moderate income debtors to behave responsibly -- to pay back some of their debts if they can -- these bills leave in place the biggest loopholes used by the wealthy. (The House bill currently has a homestead exemption cap of $250,000, but we expect even that to be removed on the floor.)

2. <u>Try to Improve the Legislation</u>

While the Republicans are not presently receptive to significant changes, we must continue to work in good faith with Senators Torricelli and Grassley (and key House members) to make improvements to the bills where possible. On a few important issues, we may be able to offer compromises that will be more attractive to the credit industry than provisions that were in the Senate bill last year. For example, we think we can propose ways to make the means test more "self-executing" by requiring judges to explain when they vary from formulaic standards and by lowering the costs to creditors for bringing abuse motions. This proposal should address at least one of the creditors' concerns with the discretion that we insist be granted to the courts. While these proposals may not be embraced by the Republicans initially, we hope they will be considered in the "end game." More importantly, these compromise provisions will allow us to present a new "Administration proposal" around which Democrats can rally.

3. <u>Senate Strategy</u>

Senior staff will consult directly with key Democratic Senators -- especially Senators Durbin, Kennedy, and Leahy -- in developing a Senate floor strategy. If Senator Torricelli is unable to lead the caucus in demanding balance for these bills, Senators Durbin and Kennedy may be willing to do so. With them, we will identify the best amendments (both germane and non-germane) to offer on the floor to provide negotiating leverage.

4. <u>House Strategy</u>

Senior staff will work with Representatives Nadler, Conyers, and possibly Frank to try to develop an alternative for full committee and floor consideration that will represent a balanced approach to bankruptcy reform. We will also seek to engage Minority Leader Gephardt and other House Democratic leaders who may view this year's debate as an opportunity to promote a strong, pro-consumer perspective. The ultimate goal will be either to greatly improve the House bill or, more likely, produce the necessary votes to sustain a possible veto in the House.

_____ Agree

_____ Disagree

THE WHITE HOUSE

WASHINGTON

April 13, 1999

MEMORANDUM TO THE NEC DEPUTIES

FROM: **The Bankruptcy Working Group**
The Y2K Liability Working Group

RE: **Materials for the Deputies meeting on Wednesday at 1:00 pm in OEOB room 180.**

* Additional attachments for Y2K will be provided at the meeting tomorrow. The material was too lengthy to fax.

THE WHITE HOUSE

WASHINGTON

April 13, 1999

For

MEMORANDUM TO THE NEC DEPUTIES

FROM: BANKRUPTCY WORKING GROUP

RE: BANKRUPTCY REFORM PROPOSAL

We are working on a strategy designed to increase our leverage, reduce the likelihood that the President will be presented with a bill that he will want to veto, and try to prevent a veto override, if a veto is necessary. Specifically, we plan to: (1) exploit publicly the vulnerabilities of the legislation (by presenting sympathetic scenarios of debtors denied access to a fresh start under the bill, attacking provisions in the bill that roll back existing protections against abusive and coercive collection practices, highlighting the bill's failure to improve disclosure and stem credit card abuses, and critiquing lingering danger it presents to child support and alimony collection); (2) work with bill proponents and opponents (including Senators Torricelli and Grassley and Representative Nadler) to advance alternative provisions that would substantively improve the current bills; (3) work with Senators Durbin, Kennedy, Leahy and others to develop a Senate floor strategy and identify message amendments which could motivate Republicans to compromise; and (4) work with Representatives Nadler, Conyers, Frank, Gephardt, and Bonior to produce a more palatable House bill, or, if that is not possible, to garner the 20-25 additional House votes necessary to sustain a veto.

The proposals attached represent work by Treasury and the Department of Justice's Executive Office of the U.S. Trustee to advance the second prong of this strategy. The position that the Administration has taken on both means testing and reaffirmations has been rejected by the Republicans on the Hill. In an effort to be constructive, Treasury and DoJ developed these proposals as alternatives -- compromises that protect our core principles yet which might be able to garner greater support among Republicans and Democrats.

Means Test: Last year, we insisted upon giving the judges adequate discretion to review whether a debtor had the capacity to repay, notwithstanding the result of the presumptive means test. Creditors balked at what they perceived as wide discretion. Upon further review, we realized that the current test in both bills would entail extraordinary wasted effort and procedural burden in determining who does and who does not have the capacity to repay. Thus, our proposal would allow a preliminary determination that someone does not have the capacity to repay (and thus can stay in Chapter 7) without individualized analysis of their actual expenses for special categories like day care, medical expenses, etc. (The current bills require this time consuming analysis for all debtors, even though we expect only a fraction to be excluded from Chapter 7 by the test.) Once those that clearly have no capacity to repay have been screened out, our proposal would require review of the actual expenses of the remaining debtors. Moreover, we would continue to require that the court have adequate discretion to overcome a presumption of ability to repay under the means test. While the procedural improvements will yield important benefits in administrative efficiency, they also may create a new framework in which we can reintroduce the importance of bounded judicial discretion.

Reaffirmations: The current bills provide virtually no additional protection against coercive reaffirmations, other than a disclosure that the debtor has a right to a hearing. The Administration proposed that all reaffirmation agreements for unsecured debt (or for debt secured by goods worth less than $500) be reviewed by the court. The creditors have objected to that proposal. Under this new proposal, the reaffirmation would be presumed to be appropriate if three standards are met: (1) the debtor is ***fully informed*** (as evidenced by a new disclosure about the terms of the credit reaffirmed and any new credit extended allowing the debtor to compare those terms to other credit available); (2) repayment of the debt does not impose ***an undue hardship*** (as evidenced by an analysis of the debtor's capacity to repay the reaffirmed debt after meeting all other nondischargeable debts); and (3) the repayment of the debt is in the debtor's ***best interest*** (with it presumed not to be in the debtor's best interest if the price of the debt is above certain high cost debt limits). In addition, other creditors whose debts are nondischargeable (e.g., former spouses and custodial parents) would be given standing to challenge whether or not the reaffirmation met these three tests. While this test will not prevent some debtors who can afford to reaffirm to do so under pressure from their creditor, it will reduce opportunities for inappropriate pressure and prevent coerced reaffirmations when they are most harmful to the debtor or other creditors.

Next Steps: If there is a consensus that these proposals would be acceptable alternatives, we would have to make a tactical decision about when to put them forward. We would try to vet the specifics with a small, select group of bankruptcy professionals and then share the ideas with staff of key members with whom we are working on Capital Hill.

At the Deputies meeting tomorrow, we will briefly review the positions taken by the Administration last year and the language on these issues in the pending bills. Then Treasury will describe these proposals and we hope to have a lively discussion about their advantages and disadvantages.

Attachments

Targeted Means Test Proposal

The principal goal of this proposal is to minimize the total cost of a means test for moving potential Chapter 7 filers who can repay some of their debt into Chapter 13. The benefit of moving filers who can repay is the increased debt repayments that would result. The direct costs of means testing include the costs to the panel trustees, bankruptcy administrators and filers of providing information for testing, the attorney's and administrative costs associated with challenges to trustees' findings, and the additional administrative costs of inappropriate referrals to Chapter 13 that result in failure. Beyond these costs are the burden of personal compliance, and the inherent rights of debtors to a fair hearing on their particular circumstances, if they are to be moved by the test. By targeting such hearings effectively, the proposal assures that virtually all debtors who truly can repay are moved fairly and at minimum cost to the system. Moreover, much as the IRS uses ability to pay guidelines today, the proposal allows for limited discretion by Trustees and judges to consider special circumstances of debtors, subject to presumptions created by the detailed guidelines. Thus, this proposal would reduce the costs of means testing compared to current bills, while still achieving comparable debt repayment.

Summary of Proposal

The resources expended to scrutinize debtors' ability to repay are related to the "payoff" in terms of expected repayment. Evidence on filers' actual ability to repay suggests that the best screen approach has two parts: low-cost screens for debtors who are unlikely to be able to repay, plus a more complete means test targeted to those who have some chance of being able to repay.

(I) *Very Low Potential to Repay:* Debtors who document incomes below 75% of the national median, adjusted for family size, are not subject to further means testing. Unless the totality of circumstances suggests abuse, it is automatically presumed that filing for Chapter 7 by such debtors is not abusive.

(II) *Low Potential to Repay:* Debtors with incomes between 75% and 150% of the national median are initially screened using a simple preliminary test of repayment capacity. This *preliminary* test calculates ability to repay the lesser of 30% of debt, or $15,000, given that they can repay a minimum of $50/month, based only on their income and the subset of allowable expenses included in the *formulaic* portions of the IRS standards, the National and Local Standards, determined only by income, family size, and area of residence. If they cannot repay according to this test, they certainly could not pay if the additional nonformulaic expenses allowed under the IRS' Other Necessary Expenses are included, and they are presumed to be filing appropriately in Chapter 7. Debtors who may be able to repay according to this screen are subject to a complete means test involving a detailed court review of the debtor's income and expenses, and any other special circumstances that substantially influence the likelihood of repayment.

(III) *Some Potential to Repay:* Debtors with incomes above 150% of the national median are fully examined for the ability to repay according to a complete means test involving a detailed court review of the debtor's income, expenses, and any special circumstances.

Unresolved Issues for Targeted Means Test Proposal

1. Inclusion of Child Support and Alimony Expenses in "Screen" Component of Means Test

The current screen requires the debtor only to provide information documenting income and family size, to keep the screen simple and minimize cost of applying it. Child support and alimony are considered, with appropriate judicial discretion for special circumstances, for all debtors subject to the full means test. If child support and alimony were included, some debtors who owe child support and alimony and are just above the "margins" of the screening test (at 75% and 150% of median income) would be more likely to have to go through the whole means test.

Pros: Allows some who owe child support and alimony to avoid a full, discretionary means test of their ability to repay.

Cons: Higher cost of screen, due to requirement that Trustee review all claims of child support and alimony obligations, not just those who are subjected to full means test. Also opens door to "fairness" arguments that other priority expenses (e.g., for elder parent or child with special needs) be included in the screen, as well as in the discretionary means test.

2. Stringency of repayment capacity in means test

Last year, we were aiming for a means test based on capacity to repay 30% of debt over a 36-month period. The current House and Senate bills use a longer time period (60 months) and lower repayment threshold (25%). We need to decide which numbers to use in our initial proposal.

3. Creditor exemption from penalties for sanctionable conduct involving debts under $1,000

Administration believes there should be no exemptions from creditor sanctions. Current House and Senate bills provide an exemption in cases of debts less than $1000, allegedly to prevent small businesses from being deterred from collecting debts in bankruptcy. Judiciary staff has signaled that they would be willing to live with an exemption only for small businesses. Should such a compromise be an initial or fallback position, or neither; and if so, what specific definition of small business would we use for the exemption?

4. Special provision for penalties against debtor attorneys that do not undertake due diligence to assure that debtor's claims are justified.

House and Senate bills include language that is unclear (perhaps deliberately so), but that may go beyond current law in creating a higher standard on debtor's attorneys. Administration could argue that this provision should be dropped - that the existing rule to encourage debtor due diligence is appropriate.

Pros: Eliminating this provision would eliminate a potential deterrent to debtor attorneys providing adequate representation to their clients in bankruptcy.

Cons: Sanctions on the debtors (rather than the attorney) are unlikely to work here, as they do in other areas of law, because a bankrupt debtor is judgment-proof. Parallelism concern: elsewhere in the bill, we endorse penalties on creditors for actions that are not substantially justified - so hard to argue against similar provision for debtors.

The following two issues are technical and can be resolved by the Working Group:

5. Should the US Trustee (Senate bill) or Panel Trustee (House bill) be responsible for followup filing

Pros for US Trustee: May have better incentives to bring motions in cases of inappropriate Chapter 7 filings, probably will be responsible for all contested cases anyway.

Pros for Panel Trustee: May know more about details of case, may lead to less of a new Federal cost burden.

6. Placeholder to allow modification of IRS standards

DOJ and Treasury believe that we want to keep the door open to possible technical modifications of the IRS standards, as Senator Torricelli suggested. However, we are unsure about how to draft legislative language that does not create too much of a burden for either Department.

DRAFT Reaffirmation Reform Proposal DRAFT

Current House and Senate Bill

The current House and Senate bills require that creditors who seek reaffirmation of wholly unsecured debts provide a disclosure that the debtor is entitled to a court hearing, and that the debtors can waive their rights to hearings if represented by counsel. Thus the court must hold a hearing to determine whether the agreement should be approved if: (1) the debtor was not represented by counsel, as required by current law, or (2) has unsecured consumer debt and was represented by counsel but did not waive the right. The bills also require that the court must find that the agreement was not the result of a threat.

Administration Position

The Administration agrees with the Bankruptcy Commission that debtors need to receive full and complete disclosure of the facts of reaffirmation agreements, that many reaffirmations involve terms that are far worse than those available elsewhere, that the existing attorney affidavit procedure provides inadequate protection from unfavorable reaffirmations. Thus, the Administration has sought additional protection against unwise reaffirmations. The Administration has endorsed court review of all reaffirmations in which the debtor was particularly vulnerable. Such reaffirmations include unsecured debt and debt secured by small personalty items of little value that might represent a basis for coercion. Finally, believing that debtors with adequate information and protection against coercion were capable of making wise decisions even in the case of unsecured credit, the Administration does not support a ban on reaffirmations of unsecured credit.

Accordingly, the Administration supported the reaffirmation reform proposed in the Grassley-Durbin bill, S. 1301. The Senate bill required that the reaffirmation agreement contain a clear disclosure of the components of the reaffirmed debt--principal, interest, late fees, creditor's attorneys fees and other costs of collection. In addition, in cases where the debt was unsecured or was for purchase of a personalty item of original value less than $250, the bill required the court to make a number of findings for approval, including finding that the agreement was in the debtor's best interest, did not impose undue hardship, was not the result of coercion, and was not excessive relative to collateral value. The Administration had sought greater protection than was included in the bill, by requiring that the court find clear and convincing evidence that the agreement was in the debtor's best interest and would not cause a hardship, and by applying the bill's provisions to debts for purchases of somewhat higher original value than $250. One criticism of the Senate proposal was that the bill language did not provide clear guidance for courts to use in deciding whether reaffirmations met the conditions for approval, so that reaffirmations would be costly to review and so that diverse standards currently used by courts might continue to be applied.

This memo outlines enhancements to the Administration proposal on reaffirmations that address the concerns about feasibility and clear guidance. It also builds on the new information on repayment capacity to be collected as part of the bankruptcy reform process – indeed, it applies the same results and standards to reaffirmations as to capacity to repay more generally – thereby limiting costs of reaffirmation review and assuring that priority debts will be paid. Thus, the enhancements to the reaffirmation proposal are largely self-executing.

Administration Proposal

The Administration supports the following reforms in bankruptcy law governing the approval of reaffirmations:

1. Court review of reaffirmations that are least likely to be in the debtors best interest, involving unsecured debt and of secured personalty debt with original purchase price under [$250/500], to determine that these reaffirmations are fully informed, voluntary, in the debtor's best interest, and do not pose undue hardship. In addition, costs and attorneys' fees cannot be added to these reaffirmations.

- Guidance to determinations that debtors have been fully informed in proposing reaffirmations and that the agreements are in debtors' best interests through an affidavit that would create rebuttable presumptions of full disclosure and best interests.

   2. Rebuttable presumptions for whether the debtor has been fully informed and the reaffirmation does not pose an undue hardship, to streamline attorney and court reviews, and provide clear standards for all parties of what constitutes a nonabusive reaffirmation. The presumptions would encourage disclosure of all relevant financial terms of the reaffirmation so that the debtor is better informed, and would apply standards analogous to those in the means test to assess the debtor's likely capacity to repay while meeting other priority obligations.

      The guidance is proposed both for courts' review where it is required or proposed to be required, and for reaffirmations in which debtor's attorneys must review and attest to the conditions.

3. No coercion: the Court must find that the agreement was not part of a threat.

4. Notice and standing for parties at interest, allowing affected creditors to object to a proposed reaffirmation that is likely to jeopardize payment of a priority debt.

Detailed Discussion of Proposal

The proposal for "no coercion" is the same as the finding required in the current House and Senate bills. We describe below the specific guidance for whether "full disclosure" has occurred, and for whether the reaffirmation constitutes an undue hardship for the debtor; and the additional standing to parties at interest to challenge proposed agreements..

Presumptions for affidavits/court approvals:

The Administration proposal creates specific conditions for a presumption of whether the debtor is fully informed about the financial implications of a proposed reaffirmation, whether the agreement imposes undue hardship and unduly jeopardizes priority debtors[, and whether the proposed reaffirmation is in the debtors best interest]. The proposal also requires a streamlined court review of a subset of reaffirmations that are least likely to be in the best interest of debtors and priority creditors. By providing clear guidance for courts, attorneys, and parties at interest in developing reaffirmations that are in the best interest of the debtor , *yet do not harm* creditors whose debt are nondischargeable, the proposal would improve the quality of all reaffirmations without imposing significant new administrative burdens on the bankruptcy system.

(1) *fully informed*: Debtor is presumed *not* to be fully informed unless the creditor who is party to the agreement discloses credit terms according to forms provided by the Judicial Conference and provides disclosures to court as part of filing. Disclosures on the form should include:

- the amount of the prepetition claim
- total amount of the reaffirmed debt, and component amounts attributable interest accrued, attorney fees, late fees, other costs relating to collection
- the monthly payment of the reaffirmed amount or, if the reaffirmation agreement extends new or additional credit, the minimum monthly payment on that amount
- annual percentage rate of interest (APR) and all other types of finance charges and their manner of calculation, including but not limited to late fees, service fees, etc, assuming that Regulation Z applies to the transaction and treats it as a refinancing; separately the same information for any new or additional credit extended[1]
- date payments start
- total number of payments made to satisfy the reaffirmed indebtedness, if paid on schedule
- if secured, date any lien is released, if payments are made on schedule
- if secured, description of collateral, value, and basis for valuation

Disclosures that meet these requirements create a presumption of full information.

(2) *undue hardship*:

A proposed agreement is presumed to be undue hardship if:

(I) the debtor's monthly income, less

(II) the greater of (a) the debtor's actual monthly expenses, or (b) the applicable monthly standards issued by the IRS for the debtor's household size and income and the area in which the

[1] There is debate over the exemption granted to credit agreements that are the result of "court proceedings" in Regulation Z. This proposal does not suggest changing this exemption.

debtor resides, if these have been determined as part of a test of abuse of 707(b), or, if not, 1.4 times applicable monthly expenses under the National and Local Standards issued by the IRS for food, clothing and other items[2]; housing and utilities; and transportation; less

(III) monthly payments to be made according to existing contracts on nondischargeable debt (not already included in monthly expenses)

is less than the sum of monthly payments in all proposed reaffirmation agreements. This test builds on the ability to repay calculation that will be part of the means test. If this test suggests that the debtor does not have the capacity to repay the reaffirmed debt, then the proposed reaffirmation is presumed to be an undue hardship. If this test suggests that the debtor has the capacity to repay the reaffirmed debt, the proposed reaffirmation is presumed not to be an undue hardship. The disclosures in this section will be made on forms provided by the Judicial Conference.

The debtor may rebut a presumption of undue hardship by demonstrating unusual circumstances that, despite the presumption, justify the proposed agreement. For debtors who were not subject to the full Chapter 7 means test or who did not have adequate ability to repay according to the means test, this would require documenting expenses and required debt payments to provide evidence that the reaffirmation does not jeopardize payment of nondischargeable debts. Other parties at interest (i.e., affected creditors) may rebut a presumption that the agreement poses no undue harm by demonstrating that the debtor's future income and/or expenses are not described adequately in the information provided by the debtor on capacity to repay. Any such evidence provided by the debtor or priority creditors can also be used by the court as a factor in determining whether the Chapter 7 filing is presumed abusive, and/or the terms of any Chapter 13 repayment plan.

[POSSIBLE ADDITION - DIFFICULTY IS IN DECIDING WHAT INTEREST RATE IS CLEARLY QUESTIONABLE FOR ALL TYPES OF REAFFIRMATIONS...

(3) *best interest*: the agreement is presumed *not* to be in the debtor's best interest unless the terms of the agreement conform to the intent of the Home Ownership and Equity Protection Act assuming it applied to reaffirmations[3], including, in particular, if the reaffirmation includes fees, or includes an effective APR more than 10 percentage points [or other appropriate number to be worked out with Fed guidance] above the average APRs of equivalent credit as reported by the Federal Reserve Board.]

Notice and standing for other parties at interest

[2] According to the data in the BLS's Consumer Expenditure Survey, average total consumer expenditures are about 40% larger than annual expenditures for the items covered in the National and Local Standards.

[3] This proposal does not suggest modifying Regulation Z--see preceding footnote.

(1) *Notification*: Debtor must notify creditors whose claims are not dischargeable of any proposed reaffirmation agreement with sufficient time to allow such creditors to object to the court's approving an agreement. [The same rules governing bankruptcy notice for creditors could be applied here.]

(2) *Standing for parties at interest*: Creditors with nondischargeable claims must have an opportunity to object to a proposed agreement. We propose modifying Sec. 524 to add a new subsection (e)(1), stating that a party in interest may object to the approval of an agreement because of substantive or procedural defects. If an objection is made, the court must hold a hearing to determine whether the agreement should be approved.

(3) *Fee shifting*: The court may award a creditor all reasonable costs in bringing an objection, if the court grants the objection and finds that the position of the debtor who proposed the agreement was not substantially justified (as guided by the presumptions described below). The court may award the debtor all reasonable costs in contesting an objection brought by a party in interest if the court does not grant the objection and the court finds that the position of the party in interest was not substantially justified, or the party brought the objection solely for the purpose of coercing a debtor into waiving a right guaranteed to the debtor.

THE WHITE HOUSE

WASHINGTON

April 13, 1999

MEMORANDUM TO NEC DEPUTIES

FROM: Y2K LIABILITY WORKING GROUP

RE: Y2K LIABILITY REFORM -- A PREVIEW

There are a number of proposals on Capitol Hill to limit liability for Y2K computer failures and change procedural rules for lawsuits stemming from such failures. Business groups have developed far-reaching proposals that have been sponsored in the Senate by Senators McCain and Hatch (in similar but rival bills) and in the House by Reps. Dreier, Davis, and others. A bill has been reported out of both the Senate Judiciary and Commerce Committees. Hearings on the House bill were held today. While Senator Feinstein has co-sponsored Senator Hatch's bill and Reps. Moran, Cramer, and Dooley cosponsored the Dreier bill, most other Democrats in the Senate and some other Democrats in the House are either opposed to any legislation or searching for an alternative that would respond to the most pressing concerns of high technology companies without reopening broader tort reform issues.

BACKGROUND -- INDUSTRY

Early this year, while a coalition of industry groups worked to produce a "consensus" bill, Senator McCain introduced his own measure (S.96) intended largely as a placeholder. Soon thereafter, the industry group completed its work and shopped the product to members. The coalition included the Chamber of Commerce, the National Association of Manufacturers, the National Wholesalers Federation, the National Federation of Independent Businesses, the Edison Electric Institute, the Information Technology Association of America, and representatives of accountants, the semiconductor industry, and large computer companies.

There are widespread rumors that the information technology industry has become disillusioned with the Chamber/NAM coalition and their unwillingness to begin discussions with Democrats about what a compromise might look like. They want a bill, but fear their coalition partners are more interested in an ideological issue. In public, the high tech companies have adhered to the coalition line; however, we have reason to believe that the Dodd-Eshoo bill (discussed below) reflects the initial list of provisions desired by the high tech companies.

BACKGROUND -- CONGRESS

In the House, the industry consensus bill was initially introduced by Representative Tom Davis (R -VA), with Representatives David Dreier (R-CA), Christopher Cox (R-CA), James Moran

(D-VA), Robert (Bud) Cramer, Jr. (D-CA) and Calvin Dooley (D-CA) as initial cosponsors. H.R. 775 now has a bipartisan group of 43 co-sponsors. Hearings on the House bill were held on April 13, 1999. The Department of Justice and John Koskinen submitted written statements for the record. (See Attachment A and B.)

The real activity thus far has been in the Senate. Senators Hatch and Feinstein cosponsored a bill (S.461) based on the industry consensus draft, with only minor changes upon which Feinstein insisted. Shortly thereafter, Senator McCain released a revised working draft of his bill which looked remarkably similar to the industry consensus proposal as well. The Commerce and Judiciary Committee Chairs have since been engaged in a public battle over jurisdiction. On March 1, 1999, the Justice Department (Eldie Acheson) testified before the Senate Judiciary Committee. In addition, John Koskinen submitted a statement expressing his view that liability legislation would do nothing to enhance readiness and could, as currently drafted, be counterproductive. (These statements are sufficiently similar to Attachments A and B that they are not provided. If you want copies, contact Sarah Rosen at the NEC.) The next day, the Senate Commerce Committee voted S. 96 (the McCain version) out of Committee on a straight party-line vote. The Judiciary Committee took up S. 461 (the Hatch-Feinstein version) on March 25, 1999. They made some modest changes, but no other Democrats joined Senator Feinstein in supporting the bill, which was reported out 10-7. The ranking Democrat on the Committee, Senator Leahy, said that the bill was "one-sided legislation that restricts the rights of American consumers, small-business owners, and family farmers who seek redress for harms caused by Year 2000 computer problems." (Leahy's statement is Attachment C.) Senators Hatch and Feinstein acknowledged that additional changes will be necessary to win support on the Senate floor.

Meanwhile, Senators Bennett and Dodd, Chairman and Ranking Member of the Senate Special Committee on Y2K, held their own hearing on March 11, 1999. There, Senator Dodd warned that "a potential escalation in Y2K litigation could further impede the efficiency of our court system, and cost taxpayers billions in inflated costs for products and services, as well as insurance premiums, as companies shift the cost burden to consumers." However, Senator Dodd also expressed concern that various bills "may go beyond what is needed to address the very valid concerns of a Y2K litigation explosion." He argued that "many interest groups will have to curb their political appetite...[leaving] broad tort reform for another day." On March 25, 1999, Senator Dodd introduced his own bill -- S. 738. (Representative Eshoo (D-CA) introduced the parallel bill -- H.R. 1319 -- in the House.) After Dodd's moderating comments, we were disappointed that his bill appeared to be hastily prepared by simply dropping certain sections of the original industry bills, while leaving many other objectionable provisions.

Specifically, the Dodd/Eshoo bills would:

- Raise pleading standards for damages, material defects, and state of mind;
- Impose a duty to mitigate on the plaintiffs (same language as the earlier bills);

- Exclude from the bill's coverage personal injury cases defined only as claims for physical injury;
- Require strict enforceability of contracts, thus preempting state unconscionability law and prohibitions on exclusions of certain warranties;
- Impose proportionate liability, with exclusions for intentional torts and impecunious plaintiffs;
- Require that, in addition to all state law elements of a claim, that plaintiffs establish that defendants created an unreasonable risk of harm;
- Make "reasonable efforts" a complete defense in tort cases and a basis for reducing damages in contracts cases; and
- Prohibit recovery for economic losses in tort cases, thereby precluding almost all business tort claims.

The Dodd/Eshoo bill does drop from the industry bills limitations on punitive damages, limitations on directors and officers liability, and class action limitations (except a requirement that claims be material).

In addition, Senator McCain is eager to reassert himself in the center of the discussion. His staff have been talking to Senator Lieberman's staff, who has significant problems with the Dodd/Eshoo bill, about a further modification that McCain might advance with Lieberman's support.

We have had preliminary discussions with staff in both the House and the Senate. Senator Leahy and Hollings' staff believe that the Republicans are finding themselves torn between high tech and traditional industry constituents. They argue we should not help advance the ball by offering an alternative now. Any proposals, even the modest ones we are considering, would be difficult for their bosses to support. Leahy is more likely than Hollings to support a minimalist alterative.

In the House, however, there is stronger pressure for an alternative soon. Staff for Representatives Gephardt, Conyers, and Lofgren met with us and were eager for us to vet an alternative proposal. In general, they had a strong wish for a silver bullet -- a proposal that would solve their dilemma -- something sufficient to address the major concerns of the high tech industry but not so offensive that it would provoke the ire of the Trial Lawyers. We are skeptical, however, that any initial alternative will be sufficient to met the most pressing industry demands and will avoid criticism from plaintiff's bar and consumer groups.

NEXT STEPS

The working group is developing a more modest, two-tiered alternative that we believe responds to the key rhetorical arguments of those who claim legislation is imperative. The first tier consists of provisions that we recommend advancing quickly to demonstrate willingness to engage constructively. The second tier is made up of provisions that have greater negative consequences. We will recommend initially holding these in reserve, until we can better assess how much demand there is for changes in these areas. However, we will seek authority to advance these second-tier proposals also, if, after discussions with Congressional Democrats, we conclude that it is important to offer these to deflect support from more damaging alternatives.

After we are authorized to move forward, we will have a general conversation with advocates for consumers and trial lawyers. Then we will discuss the proposals with staff for Senators Leahy and Hollings, the ranking members on the two committees with jurisdiction, and Senator Daschle. After hearing their views, we might discuss this package with Senator Dodd. Finally, we might consult with Senator Feinstein, who co-sponsored the Hatch bill but has indicated a desire to work with the Administration.

In the House, we would discuss these proposals with staff for Minority Leader Gephardt, Ranking Member Conyers, and Representative Zoe Lofgren, who has expressed interest in offering a very modest alternative. We also would talk with Representative Eshoo. At this time, we see no advantage to the Administration publicly offering its own proposal; instead, we envision supporting a reasonable, limited proposal offered by Democratic members in consultation with the White House. However, we would discuss these tactics with the Democratic staff noted above. Regardless of whose bill is offered, any course will inevitably lead to discussion and negotiations with Republicans to reconcile the various approaches.

We will shortly provide a detailed analysis of the Administration proposals.

Attachments

THE WHITE HOUSE

WASHINGTON

April 6, 1999

MEMORANDUM FOR THE PRESIDENT

FROM: GENE SPERLING
LARRY STEIN
MELANNE VERVEER

RE: BANKRUPTCY REFORM STRATEGY

ACTION FORCING EVENT: Bankruptcy legislation is moving rapidly through the House and the Senate. Both chambers plan to complete committee action after recess and take floor action in May. Last year, we worked closely with Senator Durbin, resulting in a 97-1 Senate vote for a moderate and balanced bill. The moderating provisions were largely abandoned in Conference. Your advisors informed Congress that they would recommend a veto of the Conference Report. The Senate never voted on the Conference Report, because Senator Durbin threatened delay and because pro-reform lobbyists --predicting Republican gains in the 1998 elections --decided to wait to reintroduce the legislation in this Congress. If the Senate had voted on the Conference Report, we do not know what the outcome would have been. The House approved the Conference Report by a veto-proof vote of 300-125. Minority Leader Gephardt was among the 80 or so Democrats supporting the Conference Report.

This year, while Congressman Nadler is leading efforts against the Conference Report and working to enlist greater support for a more moderate approach. Nonetheless, we expect the House to approve a bill like the Conference Report by a similar margin. In the Senate, there seems to be less support than previously among Democrats for fighting unbalanced legislation. Absent a strong effort by the Administration to influence the legislation, it is likely that you will be presented legislation that you will not want to sign, but which may have sufficient support to override a veto.

RECOMMENDATION: We seek your approval of a strategy designed to increase our leverage and reduce the likelihood of a veto override. Specifically, we seek authority to: (1) exploit publicly the vulnerabilities of the legislation (by presenting sympathetic scenarios of debtors denied access to a fresh start under the bill, attacking provisions in the bill that roll back existing protections against abusive and coercive collection practices, highlighting the bill's failure to improve disclosure and stem credit card abuses, and critiquing lingering danger it presents to child support and alimony collection); (2) work with bill proponents and opponents (including Senators Torricelli and Grassley and Representative Nadler) to advance alternative provisions that would substantively improve the current bills; (3) work with Senators Durbin, Kennedy, Leahy and others to develop a Senate floor strategy and identify message amendments which could motivate Republicans to compromise; and (4) work with Representatives Nadler, Conyers, Frank, Gephardt, and Bonior to produce a more palatable House bill, or, if that is not possible, to garner the 20-25 additional House votes necessary to sustain your veto.

THE STATUS OF BANKRUPTCY LEGISLATION IN CONGRESS: In the House, Representative Gekas, introduced H.R. 833, which is virtually identical to last year's Conference Report. It now has 93 cosponsors, including nearly 40 Democrats (*e.g.*, Representatives Boucher, Frost, Kennedy, Holden, Menendez, Roemer, Maloney, and Velazquez). Minority Leader Gephardt supported the Conference Report last year, and would likely do so again (albeit with a low profile). However, if a strong balanced alternative can be constructed that has the strong public backing of the White House, Gephardt might be willing to rally his caucus vigorously around such a vehicle.

Representatives Conyers and Nadler recently wrote to you praising you and the First lady for your leadership last year and asking you to reiterate your opposition to last year's Conference Report. On March 23, 1999, Jack Lew sent a reply noting that your senior advisors had recommended a veto of the Conference Report last year and that "our position . . . has not changed." Armed with that letter and an alternative bill being developed by a group of bankruptcy experts at the National Bankruptcy Conference, Representative Nadler is confident (perhaps more than we are) that he can prevent some Democrats, who last year supported the Conference Report, from doing so this year. Achieving this goal is critical to a credible veto threat.

In the Senate, we originally hoped that Senator Torricelli would not co-sponsor Senator Grassley's bill (which is modeled after the Conference Report) demonstrating to other Democrats that the bill was not ready for the caucus' support. Unfortunately, Senator Torricelli did agree to cosponsor S. 625, although extracted some moderating changes as a precondition of his sponsorship. He also wrote a letter to Senator Grassley outlining six areas where the bill needs to be improved before it leaves the Senate. Although we would like to see some other changes as well, we largely agree with the six areas that Torricelli outlined. (The First Lady urged Senator Torricelli to hold firm on these issues.) We are skeptical, however, that the Republicans will accept many of these amendments either in committee or on the floor. Even if they did, as last year, we can expect any progress made to be undone in conference with the House.

Senator Grassley is more reasonable on bankruptcy than many Republicans, but we do not believe that he will be able to hold off his colleagues who believe they can get Democratic support without further compromise. Senator Biden is already a co-sponsor and five or six other Democrats have expressed interest in signing on the bill. Senator Leahy also may support the bill in Committee as a demonstration of support for Senator Torricelli, who replaced Senator Durbin as ranking member on the relevant subcommittee. Many signs suggest that Senator Torricelli will not oppose the bill even if the additional changes he seeks are not made. Senator Daschle, who wants a bankruptcy reform bill, will likely support S. 625 in the end if enough Democrats move in that direction. Well positioned Democratic staff believe there may be enough votes in the Senate to override a Presidential veto. Finally, last year, Banking Committee Chairman D'Amato raised no objection to provisions inserted on the Senate floor that required credit card companies to provide greater disclosure to consumers.

These provisions were important to our support of the Senate bill. However, the new Banking Committee Chairman, Senator Gramm, recently noted his opposition to any bankruptcy bill which contains the credit card protections that we view as important. Senator Gramm has reportedly said that a bill with these consumer protections "will pass over [his] dead body."

At this time, neither the Administration nor effective advocates like Senator Kennedy have mounted any offensive. Thus, our assessment is preliminary and we hope to affect it. Some House and Senate Democrats are looking to the White House for political guidance and leadership on this issue. While they want to support bankruptcy legislation, we should be able to keep them from supporting the bills moving in each chamber if we give them a viable alternative and a strong rationale not to do so.

RECOMMENDED STRATEGY: While we believe that the current bills before Congress are sufficiently flawed as to merit continued opposition, we also believe that bankruptcy reform is not only desirable but necessary. Our goal is to gain sufficient leverage in the debate on Capitol Hill to make modest but important changes to the bills, so that we could recommend that you sign the resultant legislation. We recommend the four-prong strategy described below.

1. <u>Exploit Vulnerabilities</u>

It is difficult to rally Members or the public around complicated technical issues like nondischargeable debt and means test formulas. However, there are messages we can use to address each of our major areas of concern.

A. The Formulaic Means Test Will Block Efforts of Responsible Debtors to Get Back on Their Feet

One of our most significant concerns with the current bill is that the procedures established do not afford debtors a meaningful opportunity to have their specific circumstances evaluated and do not give the court the necessary discretion to take those circumstances into consideration. While it is difficult to defend judicial discretion, we can tell stories about sympathetic debtors who would be caught by the bill's rigid approach.

Under the bill, the bankruptcy trustee would determine whether a debtor can afford to repay some of their debts by considering the debtor's income, less certain standard allowances for food, clothing, transportation, and housing expenses rather than what the debtor actually spends for those items. There may be cases where the actual expenses are above the allowance amount for good reason, but the court can only provide an exception if the debtor meets the burden of proving that their circumstances "exceptional" and the additional expenses "necessary."

So, for example:

- No exception likely would be made for a debtor who helped his non-dependent mother meet her expenses so that she could live on her own and stay out of a nursing home. That debtor could be denied access to Chapter 7's "fresh start" and the funds used to pay for his mother's housing expenses would instead go to pay off his credit cards.

- Similar problems arise especially in ethic and lower-income communities where neighbors, friends, and relatives often bear significant costs to help children, elderly, the disabled, the unemployed, and others who are not legally their dependants.

- No allowance likely would be made if a debtor's transportation expenses to get to work on the other side of town are above the area allowance. The choice posed could be stark: (1) find a job closer to home (even if less likely to provide career advancement) to lower transportation costs and free up money to repay your creditors; or (2) fail to feed or cloth your children.

- No allowance likely would be made if the debtor's rental costs are higher than the area allowance, even though her apartment allows her to live near to a relative who can safely watch the children after school. The current test could force that single mother to move her family from her home without an opportunity for individualized assessment of the tradeoffs.

In addition to these scenarios, we can make much of the false representation made by bill proponents that the bill no longer would impact below-median income debtors (who make up 80% of those in bankruptcy). All debtors would be subject to the new mean test; while creditors could only bring "abuse" motions against above-median income debtors, the bankruptcy courts and trustees would be required to apply the means test to all debtors.

B. The Bills Roll Back Existing Protections Against Abusive Collection Practices and Coercion.

In a famous, recent case, Sears was found to have harassed creditors into agreeing to repay debts that they no longer had -- having been discharged in bankruptcy. The court found that Sears had violated the "discharge injunction" and was liable for millions of dollars in damages to hundreds of thousands of debtors. Under the House bill, creditors could harass debtors to repay discharged debt with little fear of consequences, as class actions and punitive damages -- the tools that brought the Sears' practices to an end -- would be barred.

Another concern is the bill's failure to deal with coerced reaffirmations of debt. Thousands of bankruptcy debtors each year agree to "reaffirm" one or more debts -- agreeing to pay it back even though they have the right to have the debt discharged in bankruptcy. We have no objection to letting debtors make an informed choice about whether to repay debts. There is widespread evidence, however, that debtors' decisions are not informed and that creditors coerce debtors into reaffirming debts by threatening to challenge the bankruptcy proceedings if they do not reaffirm, promising new credit lines in exchange for reaffirmation, and harassing collection efforts aimed at debtors ignorant of their rights. Provisions of these bills will create new opportunities for creditors to threaten and harass debtors.

In numerous cases, debtors "agree" to reaffirm debts even though they do not have sufficient income to pay their current expenses. While some may be optimistic, many more feel they have no choice when approached by a creditor threatening to challenge their bankruptcy. It would not be unusual to see a reaffirmation agreement, for example, where the debtor agrees to repay $1000 in order to get a $500 line of credit -- an effective interest rate of 200% on the new debt, even though far less expensive credit lines are now available even for those currently in bankruptcy. Even where a debtor makes an informed choice, ***reaffirming the debt may harm ex-spouses and children whose child support and alimony may not get paid because the reaffirmed debt is paid instead.***

The Bankruptcy Review Commission concluded that reaffirmations of unsecured debt should be banned outright. We proposed instead a "coercion" check -- a review by the bankruptcy court of any reaffirmation of unsecured debt to ensure that it was an informed choice in the best interest of the debtor and others. We will press this issue more visibly this year, while developing compromise alternatives that we could offer in final negotiations.

C. Consumer's Right-to-Know and Protection from Credit Card Abuse

Consumers are well aware of intense and misleading credit card marketing efforts. Last year's Senate bill contained a number of important credit card provisions including: (1) a requirement that credit card companies disclose on monthly statements how long it would take (and how much it would cost) to pay back the debt, if consumers only made the minimum payment; (2) a requirement that consumers be notified when credit card companies or retailers take a security interest in the goods purchased; and (3) a requirement that credit card companies inform debtors that they have not assessed the debtors' capacity to repay additional debt and provide a worksheet so that the debtor can easily make that calculation for themselves. These provisions were stripped in conference, leaving only a requirement for the Federal Reserve to study what further disclosures would be helpful.

Senator Sarbanes and other Democrats have introduced legislation separate from the bankruptcy bill that incorporates many of these consumer education provisions. In addition, Representative LaFalce and Senator Schumer have introduced bills that contain a host of additional credit card protections, many of which the Administration supports. One, for example, would eliminate the misleading advertising of credit card "teaser" rates -- which leave consumers shocked by dramatic interest rate increases when rates expire or they incur a penalty for a minor late payment. You are scheduled to unveil a consumer financial protection package the week that Congress returns, which includes many of these credit card provisions, as well as privacy protections. At that time, you can praise the efforts of Democrats in both chambers to protect consumers against abusive credit card practices. While we will not make passage of any *specific* credit card provisions a precondition for bankruptcy support, some balance in this regard is essential. By raising the profile of credit card issues, you will increase the leverage of Democrats seeking to incorporate some of these provisions in the bankruptcy bill and give Democrats an issue around which they can rally.

D. Child Support and Alimony Collection

The bankruptcy bills create or expand categories of nondischargeable debts -- i.e., debts that can be collected after bankruptcy. Last year we argued that these new nondischargeable debts would impair the collection of child support and alimony. In response, the bills' proponents both narrowed the categories of new nondischargeable debts and added a host of provisions that genuinely make it easier for former spouses and custodial parents to collect child support and alimony from debtors in bankruptcy. As a result, the bills probably improve the collection of family support obligations more than it is harmed. However, the bills have not been entirely corrected in this regard. We can continue, therefore, to argue credibly that child support and alimony collection is harmed *in some cases*. In particular, two concerns remain:

(1) the bills now provide that, in the supervised context of a bankruptcy plan, child support and alimony payments must be given the highest priority. However, under these bills, some debtors will have obligations to repay reaffirmed or newly nondischargeable debt. After the bankruptcy discharge, there is no court supervision or other mechanism to ensure that child support and alimony are paid first. The custodial parent or former spouse is unlikely to be as effective as the card company in collecting payment. Once these lower-priority payments are made, it is not practical to require the custodial parent or former spouse to go after the creditor to assert a claim on those payments.

(2) the bills also raise another concern for the payment of child support and alimony. If debtors are forced into Chapter 13 who do not genuinely have the capacity to repay -- as we fear will occur under the current versions of the means test -- they will eventually return to Chapter 7 with a diminished ability to repay their nondischargeable debts -- in particular their child support and alimony -- because while under the plan, they devoted some of their assets to paying their other creditors.

E. The Bills Leave in Place Huge Loopholes for Wealthy Homeowners While Squeezing Low and Moderate Income Debtors in over Their Heads.

Some of the most famous cases of abuse involve celebrities who file for bankruptcy and walk away from most of their debts but continue to live in multimillion dollar mansions protected by "homestead exemptions." (State exemptions also protect such luxuries as race horses and silver spoons in Virginia.)

Yet, at the same time we are creating a system that will ask low and moderate income debtors to behave responsibly -- to pay back some of their debts if they can -- these bills leave in place the biggest loopholes used by the wealthy. (The House bill currently has a homestead exemption cap of $250,000, but we expect even that to be removed on the floor.)

2. **Try to Improve the Legislation**

While the Republicans are not presently receptive to significant changes, we must continue to work in good faith with Senators Torricelli and Grassley (and key House members) to make improvements to the bills where possible. On a few important issues, we may be able to offer compromises that will be more attractive to the credit industry than provisions that were in the Senate bill last year. For example, we think we can propose ways to make the means test more "self-executing" by requiring judges to explain when they vary from formulaic standards and by lowering the costs to creditors for bringing abuse motions. This proposal should address at least one of the creditors' concerns with the discretion that we insist be granted to the courts. While these proposals may not be embraced by the Republicans initially, we hope they will be considered in the "end game." More importantly, these compromise provisions will allow us to present a new "Administration proposal" around which Democrats can rally.

3. **Senate Strategy**

Senior staff will consult directly with key Democratic Senators -- especially Senators Durbin, Kennedy, and Leahy -- in developing a Senate floor strategy. If Senator Torricelli is unable to lead the caucus in demanding balance for these bills, Senators Durbin and Kennedy may be willing to do so. With them, we will identify the best amendments (both germane and non-germane) to offer on the floor to provide negotiating leverage.

4. **House Strategy**

Senior staff will work with Representatives Nadler, Conyers, and possibly Frank to try to develop an alternative for full committee and floor consideration that will represent a balanced approach to bankruptcy reform. We will also seek to engage Minority Leader Gephardt and other House Democratic leaders who may view this year's debate as an opportunity to promote a strong, pro-consumer perspective. The ultimate goal will be either to greatly improve the House bill or, more likely, produce the necessary votes to sustain a possible veto in the House.

_____ Agree

_____ Disagree

Nicole R. Rabner

07/14/99 06:17:38 PM

Record Type: Record

To: Katharine Button/WHO/EOP@EOP, Marsha E. Berry/WHO/EOP@EOP

cc:

Subject: bankruptcy article

KT-- please show MV the Economist article below (HRC reference at the end).

The Economist Newspaper

July 03, 1999, U.S. Edition

LENGTH: 538 words

HEADLINE: Deeper in debt

DATELINE: new york

BODY:

IF AMERICA'S bubble economy bursts, a finger of blame is sure to point at the credit-card industry. The constant stream of junk mail offering pre-approved credit on a charge-card has helped huge numbers of people to get deeper and faster into debt than has ever been possible before. This has fuelled the mother of all consumption splurges. And, as buying shares with borrowed money has become a working-class addiction, it has also helped to pump up the stockmarket.

Given its readiness to hand out money with almost no questions asked, the credit-card industry's current demands that Congress stop the rapid increase in filings for personal bankruptcy ring hollow. No doubt, many people have benefited from the credit revolution that gave them an ability to borrow they were denied in the past. And certainly, borrowers unable to meet their obligations bear some responsibility for their woes. Yet it is pure hypocrisy for credit-card firms to complain that personal bankruptcy has lost its traditional stigma. For they have been deliberately directing their sales efforts at people on the edge of financial distress.

The profit margins on credit-card lending are among the highest on any financial product. And, as any banker will tell you, higher returns are the reward for taking higher risks. Anyone with a modicum of financial savvy knows that if you do not pay off your credit card each month you suffer punitive rates of interest. That the credit-card industry makes most of its money from interest payments suggests that its most valuable customers are the least sophisticated financially.

This has not stopped the credit-card industry from lobbying furiously for Congress to make it more difficult for people to escape their debts by filing for bankruptcy. Its dollars have purchased a bipartisan effort to change the law. Its exact form is not yet clear, but it seems likely that legislation will be approved later this year, against approving background noise from politicians lamenting the moral decline that has led to widespread abuse of the old bankruptcy law. Yet, according to a study by Elizabeth Warren of Harvard Law School, there is no evidence that most people who file for bankruptcy are taking advantage of the system. On the contrary, most of them go bust only after having suffered a serious financial shock -- such as losing a job, needing expensive medical care while uninsured or getting divorced.

Curiously, the proposed reforms do not address the abuse of the bankruptcy code for which there is most evidence -- the ability of the wealthy to buy mansions in states such as Florida which their creditors cannot touch should they declare bankruptcy. Nor will the reforms require credit-card companies to ensure that their customers understand the long-term cost of the credit they are granted.

Can anybody stop the credit-card companies changing the rules after the game has started (and before the economy turns down, and the full extent of the debt mess becomes clear)? The most vocal opponent of the proposed reforms is Hillary Clinton, who may be able to persuade her husband to veto the new law, if only in order to start to repay his own mountain of debt to the First Lady.

PERSONAL FINANCIAL INFORMATION:
DO CONSUMERS GET PRIVACY OR PIRACY?

Contents

WHAT'S WRONG WITH THE PRIVACY PROVISIONS IN H.R. 10 AND WHAT CONGRESS CAN DO TO FIX IT

Simply put. the House-passed privacy provisions in HR 10 fail to protect consumers' financial privacy. Consumers need the ability to control the sharing of their financial data – notice, access and at least the chance to say "no" to sharing financial information with *any* entity.

What's in HR 10?

- **Limited Notice Provisions:** HR 10 requires only that an institution notify consumers about their policies and practices related to "protecting" the information or disclosing to nonaffiliated third parties. There is no requirement to tell consumers about the types of information collected or the information sharing practices related to affiliates and any other entity or person.

- **Opt-Out to "Nonaffiliated Third Parties" Only**: The provision's limited third party opt-out does not apply at all to internal affiliate sharing—affiliates can still share and sell information and consumers have no ability to stop them.

- **Marketing still Permitted with Nonaffiliated Third Parties**: Even if a consumer opts-out, information may still be shared with third parties *marketing* financial products on behalf the institution or pursuant to a "joint agreement" between two or more financial institutions to offer, endorse or sponsor a financial product. Therefore, with regard to *any* financial product, the consumer has no right to stop the disclosure of their information.

- **Loopholes Galore**: A number of loopholes exist in the bill that could allow financial institutions to share a customers information without notice to the customer or allowing that customer to have the ability to opt-out.

What Can Congress do to Provide *Real* Privacy Protection?

- **Notice about Information Sharing Practices with *All Entities*:** Require institutions to provide full disclosure of their information sharing policies with all entities. including the categories of information collected and categories of persons/entities to whom the information may be shared. Consumers need to be meaningfully and fully informed about the institution's information sharing and privacy practices.

- **Opt-Out of Information Sharing with *All Entities – Affiliates and All Third Parties – for All Purposes*:** Give consumers an across the board opt-out so they could say "no" to information sharing, for any purpose. with affiliates and third parties. This is the minimum protection consumers need – anything less is sanctioning widespread information sharing and violations of consumers' privacy. Even better, financial firms should not be permitted to share or sell a consumer's financial information with any entity, affiliate or third party, without the consumer's prior consent – an "opt-in."

- **Access to Information:** HR 10 does not provide any access to data for consumers. Consumers should have access to the information institutions hold on them to ensure the information is accurate and relevant and the ability to correct erroneous information. Consumers should also be able to hold institutions that violate their privacy accountable for the violations.

- **Security and Protection of Data**: The holders of data are in the best position to protect and secure the information on consumers. Banks and other financial firms should have a duty to protect the confidentiality of customers' financial and personal information and be held legally responsible when they violate the confidentiality standards.

Why is it Important for Consumers to have the Choice to Stop information Sharing with Affiliates?

- **Harm to Consumers from Affiliate Sharing is Great:** Financial firms are interested in sharing information with and selling the products of their affiliates. Financial institutions can use affiliates to sell or market any of their products. Rather than use third parties, they will simply bring everything into the affiliate structure.

  The most glaring example of the harm from unauthorized information sharing involves affiliate sharing -- the *NationsBank* case in which *NationsBank /Securities* settled securities laws violations by paying $7 million to the SEC and other agencies. The allegations included the bank sharing lists of customers with expiring CDs with NationsSecurities. The securities *affiliate* allegedly sold uninsured, risky products in a misleading manner that were not suitable to unsuspecting CD holders. Thousands of consumers were affected, losing portions of their life savings. <u>HR 10 as passed by the House does nothing to address this affiliate sharing problem but rather, gives its okay to widespread affiliate sharing without giving consumers any ability to stop such sharing.</u>

  As Representative Barton (R-TX), who co-sponsored with Rep. Markey the stronger privacy amendment that was denied a vote by the House Rules Committee, stated on the floor during the debate over HR 10 on July 1, 1999 --

  > *The question I ask this body and this country is: If we are concerned about the selling and sharing of information to third parties, should we not be just as concerned about the selling, sharing, transmitting, or accessing that information inside of these affiliates if there are going to be dozens or hundreds of these affiliates? ...* ***Until we solve the riddle of handling information within the affiliate structure, we do not have privacy. We do not have privacy.***

CONSUMERS CARE ABOUT PRIVACY PROTECTION AND CONTROLLING HOW THEIR PERSONAL INFORMATION IS USED

- **80% of those surveyed agreed that "Consumers have lost all control over how personal information is circulated and used by companies."**

- **88% are concerned about threats to privacy. 55% are very concerned about those threats.**

From a 1998 Poll by Lou Harris.

CONSUMERS LACK CONFIDENCE THAT EXISTING LAWS ARE ADEQUATE TO PROTECT PERSONAL INFORMATION AND
A MAJORITY SAY NO TO AFFILIATE SHARING OF INFORMATION

- **92% surveyed say they would mind if a company they did business with sold information about them to another company.**

- **78% did not agree that current federal and state laws are strong enough to protect personal privacy from businesses that collect information about consumers.**

- **81% opposed the internal sharing of customer personal and financial information by corporate affiliates.**

- **Only 10% said they would support newly merged banks, insurance companies and investment firms sharing customer information about accounts or insurance policies and *the majority of these said that affiliated companies should be required to notify and obtain written permission from customers before sharing their personal information.***

From a 1998 AARP Survey.

The Washington Post

AN INDEPENDENT NEWSPAPER

Whose Financial Data?

CONGRESS HAS spent so many years trying to reform the laws regulating banks and other financial institutions that it would be rash to predict success in this session. It's true that the House and Senate now agree on what was for years the most contentious issue: repealing the Depression-era ban on cross-ownership among banks, insurance companies and securities houses.

But three areas of dispute continue to jeopardize final passage. The Treasury and the Fed still disagree about what corporate structure would best guarantee that federal insurance of bank deposits isn't unwittingly extended to nonbanking activities. Then there is disagreement about the Community Redevelopment Act, which has successfully encouraged banks to lend more to poor neighborhoods. The Senate version of the bill would weaken the CRA.

The biggest controversy in the House, though, has to do with privacy. The financial institutions want to retain ownership of all the information they collect about their customers. They can profitably sell such data; they also can use it, they argue, to offer improved services. But where the financial institutions see gains for consumers, some members of Congress see risk in the sharing of information across institutional divides. A bank could let its securities affiliate know when an elderly customer's certificate of deposit was expiring, setting the customer up for exploitation with a riskier financial product. Insurance companies with knowledge of a customer's poor health could warn a mortgage affiliate not to make a loan. And so on.

The House Commerce Committee approved, with bipartisan support, a compromise solution. Financial institutions would be able to sell most information, with the exception of medical data, and share such information among affiliates. But customers would be given the right to say no—to request that their information not be shared. This "opt-out" is less sweeping than what some self-styled consumer advocates wanted—that is, no sharing without express approval from each customer. But most industry lobbyists oppose even this modest measure, and the House leadership may keep the Commerce Committee version from coming to the floor. That would be a mistake; the House should be allowed to vote on a provision that would give consumers a bit of increased protection as financial institutions bulk up.

USA TODAY 6-10-99

Banking privacy laws stir legal debate

Minnesota case tackles sale of customer info

By Christine Dugas
USA TODAY

While Congress was considering whether to tighten bank privacy laws Wednesday, Minnesota's attorney general was suing a Minneapolis-based bank for illegally selling customer information to a telemarketing firm.

Attorney General Mike Hatch says that among other things U.S. Bank violated the federal Fair Credit Reporting Act by selling private customer information, such as Social Security numbers and account balances, to Member Works of Stamford, Conn.

Hatch says the bank received $4 million plus commissions for providing information on nearly 1 million customers across the Midwest and West.

Member Works, a publicly traded company, markets various membership programs that, for example, offer consumers travel and health care discounts.

Some of the nearly 50 consumers who complained to Hatch's office said bills had appeared on their credit card statements even though they never were contacted by Member Works. Others said money was debited from checking accounts without authorization.

"We are confident that our marketing standards operate well beyond current industry practices, as well as all state and federal regulations," said Member Works spokesman Wayne Gattinella.

U.S. Bank denied it has violated any laws. "In today's world, joint ventures and cooperative marketing programs are common practices in bringing benefits to customers," said Donn Waage, public relations director at U.S. Bancorp, the parent company.

The sale of customer information goes beyond U.S. Bank. Comptroller of the Currency John Hawke Jr., who regulates banks, says his office has received calls from attorneys general in other states about privacy issues.

"We are not sure how widespread such practices are," he said. "But we are collecting the information and will be looking into it further."

"Privacy shouldn't be for sale," says Ed Mierzwinski of U.S. Public Interest Research Group. "It's outrageous and it's also outrageous that the financial lobby is lined up against reform."

Today the House Commerce Committee votes on a privacy amendment to the financial modernization bill. The amendment, sponsored by Rep. Edward Markey, D-Mass., would give consumers the right to say no if they didn't want their bank to share information with affiliates, and it would require the bank to get a customer's consent to share information with anyone outside the company.

WASHINGTON POST 6-17-99

Edward Markey

Your Secrets For Sale

There are few things that people value more than their privacy, especially when it comes to their personal finances. A record of the checks you write, the charges you make on your credit card, the stocks you buy, your insurance claims—they tell as much or more about you than a personal diary.

Yet this personal diary is not kept under your bed or locked in your desk. It is held by a financial institution on terms that often do not coincide with its confidential, sensitive, personal character. In fact, financial institutions benefit from obsolete laws and rules that permit this information to be shared with people without your permission, and even sold to others who are not even part of the bank or securities firm with which you were doing business. Some of this can be explained as necessary for "efficiency," but much of it can only be explained as unnecessary angling for competitive advantage at the expense of personal privacy.

Shouldn't you have a say if your bank or broker wants to share your personal information with another institution? Shouldn't you be the one to decide whether your personal profile is put up for sale?

It sounds reasonable enough, but the fact is that you have very little control over the distribution of your own financial records. Current law allows financial firms to share your personal financial information without your knowledge or consent.

Concerns about financial privacy are heightened by the increase in bank mergers with insurance companies and investment firms. Once they merge, financial institutions are under no restrictions on sharing customer information from division to division.

For instance, your life insurance records could be made available to the loan officer considering your mortgage application. Or a grieving spouse could become a target for investment pitches as the financial "holding company" looks for "synergies" by sharing her insurance information with a securities affiliate.

Congress is now considering a bill to modernize the financial services industry. This is the ideal vehicle for commonsense measures to protect consumers' privacy. But right now, the bill falls short. Consumer advocates and privacy experts agree that a strong financial privacy bill should:

(1) Give customers the right to say "no" to institutions sharing personal financial information with their affiliates and prohibit any transfer of personally identifiable information to third parties without the customers' consent.

(2) Give customers the right to recover their losses when a financial firm violates their privacy.

(3) Allow customers to review their personal information for accuracy, and give them the right to correct erroneous information.

During consideration of the bill by the Commerce Committee, I succeeded in adding only the right to say "no." However, commercial interests oppose even this small gain so vehemently that they are threatening to kill the entire financial services bill if this provision is retained.

I support reforming our financial services laws for the sake of leveling the competitive playing field among financial service providers. But if the cost of such reform is that we fail to close the gaping privacy loopholes now riddling our financial system, the industry can sell your secrets to anyone. The special interests will have their cake and eat our privacy too.

The writer is a Democratic representative from Massachusetts.

TOPEKA CAPITAL JOURNAL

July 25, 1999, Sunday

LENGTH: 856 words

HEADLINE: **'Jane Bryant Quinn:** Think your financial affairs private? Dont bank on it

BODY: NEW YORK -- You probably think that your bank keeps mum about your financial affairs. Think again. May be selling you down the river, to earn some extra money.

Many banks sell your confidential account information to telemarketing firms. Salespeople then call you, flogging discount dental plans, travel clubs and other products.

Monthly payments are deducted automatically from your bank account or charged to your credit card. The bank earns commissions on the sales.

Comptroller of the Currency John D. Hawke Jr. calls some of these practices "seamy, if not downright unfair and deceptive." You can try to get off the sales list (see below), but might not be able to.

When the telephone salespeople call you, what might they know? Plenty.

Besides your name, age, address and phone number, the bank might have disclosed your bank account number, Social Security number, current checking account balance, credit limit, credit score (showing how creditworthy you are), the number and type of credit cards you carry and what you owe on your credit card accounts.

A case recently brought by Minnesota Attorney General Mike Hatch against Minneapolis-based U.S. Bancorp charged that some customers had their bank accounts and credit cards debited, even though they didn't want the service.

U.S. Bancorp, which has 1,023 affiliated banks and branches, settled the case with no admission of wrongdoing. But it agreed to fines, restitution and charitable contributions of about $3 millionthe approximate amount it had earned on sales-commissions.

Theoretically, the Fair Credit Reporting Act (FCRA) limits the way some of your financial records can be used.

FCRA covers credit information, for example, your income, assets and employment history. Under the law, banks have to tell you that they might disclose this information, and give you a chance to take your name off the telemarketing lists. This is called "opting out."

Unfortunately, there is no effective way of enforcing FCRA, says Hawke, whose office regulates 2,400 national banks. The regulators don't know what the banks are doing, and few customers know they can opt out.

What's more, no federal law protects what's called "transaction and experience" information namely, the details of your bank and credit card accounts. They can be disclosed to telemarketers at will, says

Amy Friend, assistant chief counsel at the Office of the Comptroller of the Currency. So can your Social Security number. U.S. Bancorp had a deal with a telemarketer called Member Works in Stamford, Conn., which, says Hatch, has worked with 17 of the 25 largest banks. Hatch sued Member Works last week, charging deceptive practices. The company denies the charge.

As part of its settlement, U.S. Bancorp agreed to stop working with outside telemarketers selling nonfinancial products. Wells Fargo and Bank of America announced that they would do the same.

But they can still disclose your confidential account information to telemarketers selling financial products, for example, insurance and securities.

Chase Manhattan says it's revising its telemarketing policy. Bank One says it gives telemarketers only name, address and phone number.

A financial-restructuring bill in Congress would give you opt-out rights when banks sell your account information to third-party marketers who are peddling nonfinancial products, such as dental plans.

But industry lobbyists and the congressional leadership defeated attempts to give you even better protection. You'll still have no **privacy** rights, if your bank wants to give your confidential information to affiliated telemarketers or peddlers of financial products. If you don't want your account information disclosed to telemarketers, here's what to try:(1) Call your bank and get the name of the person in charge of customer relations. Write a letter, saying that you want to exercise your legal right, under FCRA, to keep your credit information from being disclosed.

Also say that you don't want your bank and credit-card account data disclosed to anyone selling financial or nonfinancial products, including the bank's own affiliates. Some banks might agree, although they don't have to. Ask the bank to acknowledge your letter.

(2) Write to the president of the bank, saying that you're shocked to learn that your bank and credit-card account information can be disclosed. The more top officials hear this, the better. Ask specifically whether the bank shares your account information with affiliated or nonaffiliated companies.

A mere **privacy** statement isn't enough. U.S. Bancorp's **privacy** statement read, "all personal information you supply to us will be considered confidential," but it sold your data just the same.

(3) Tell your senator and representative that you want an enforceable opt-out right for all telemarketers, including those affiliated with financial institutions. Unless Congress hears from the public, the industry's dollars will rule.

Jane Bryant Quinn welcomes letters on money issues and problems but cannot offer individual financial advice.

Washington Post Writers Group

LOAD-DATE: July 26, 1999

The **Dallas Morning News**

View Related Topics

June 28, 1999, Monday THIRD EDITION

SECTION: EDITORIALS; Pg. 12A; EDITORIALS

LENGTH: 448 words

HEADLINE: Privacy Issues;
How much customer information should be shared?

BODY:
Until recently, insurance, banking and brokerage interests pretty much have had their way on **privacy** issues in Congress' banking modernization debate.

The Senate's modernization measure that passed earlier this year didn't address whether a financial institution's banking, insurance and brokerage affiliates could share sensitive customer files. Similarly, the House Banking Committee's version tepidly mandated companies to disclose their **privacy** policies.

But the House Commerce Committee recently voted to allow customers to block companies from sharing sensitive, nonpublic financial customer information with affiliates or nonfinancial third parties for marketing purposes.

But even this provision, loudly opposed by financial institutions, has a big loophole that allows banks to use information as long as the customer hasn't instructed to the contrary. Requiring institutions to obtain prior customer approval, as is commonly the case in Europe, would offer better consumer protection.

At last, Congress has nabbed the industry's attention on **privacy,** an issue that until now had been on the edge of modernization deliberations. Mega banks and financial service firms amass a vast inventory of personal financial information that warrant more than industry promises of protection.

Customer **privacy** is no small matter, in part, because modern technology makes timely financial information extremely valuable. Many financial service companies already sell credit card and checking account information, birth dates, addresses and telephone numbers to outsiders.

Worried by the trend, Comptroller of the Currency John D. Hawke Jr. has repeatedly criticized the sale of customer information as "seamy" and legally questionable. In Minnesota, the state's attorney general is locked in a lawsuit with U.S. Bancorp, which it accuses of selling customer information to telemarketing firms in violation of the bank's own **privacy** policies. There are also allegations in the case that some telemarketers may have used credit card information to sign up customers for products and services they didn't order.

To its credit, Bank of America has promised to stop sharing certain customer information with telemarketers. Several other banks also are looking at their policies and procedures.

Reforms to end regulatory fire walls between banks, insurance companies and securities firms are long overdue. Financial institutions need additional flexibility and muscle to compete globally. Consumers, however, must regain some rights to determine how their financial histories are used, and must have reasonable assurances that confidential information will not be abused.

LANGUAGE: ENGLISH

LOAD-DATE: June 28, 1999

FOCUS™

Search: General News;Privacy, Dallas Morning News

To narrow this search, please enter a word or phrase:

FOCUS

Example: **House of Representatives**

Los Angeles Times

View Related Topics

June 14, 1999, Monday, Home Edition

SECTION: Metro; Part B; Page 4; No Desk

LENGTH: 493 words

HEADLINE: PRIVACY ABUSES BY BANKS

BODY:

Banks are no longer the friendly, discreet custodians of their depositors' money, judging by hundreds of thousands of consumer complaints to federal and state banking regulators. In fact, without public knowledge, banks are making millions peddling crucial information about their depositors. The abuse--especially by the large national banks--gives a new definition to bank robbery. Federal regulators have taken notice, and some states are hauling banks into court.

In California, Bank of America announced Friday that it will no longer sell customer information to third parties. Fine. But Wells Fargo and U.S. Bancorp say they will take only limited remedial steps. For the most part, other banks are silent on the issue. The best way to stop this abuse is through legislative protection of consumer **privacy.**

Financial **privacy** is under assault from all directions. The California Legislature, for instance, enacted a law to allow the state to sell personal income data, and only Gov. Gray Davis' last-minute intervention blocked its implementation. As objectionable as that law is, it at least gives taxpayers some say in the release of the information. Banks are not subject to such constraints.

In a practice that Comptroller of the Currency John D. Hawke Jr., the regulator of federally chartered banks, calls unfair and abusive, some banks regularly and without any legal restraint sell data about their customers to telemarketing companies in exchange for a commission. And it's not just names and phone numbers the banks sell. It's Social Security numbers, birth dates, credit card numbers and purchases, occupations, marital status, credit standing and account balances.

Some banks will even allow telemarketers to automatically charge the accounts of customers who express an interest in the telemarketers' products or services. Minnesota has filed a lawsuit against U.S. Bancorp over such practices, accusing the bank holding company of violating the Fair Credit Reporting Act.

The House Commerce Committee last Thursday adopted an amendment to force banks to disclose their **privacy** policies and allow consumers to block release of their personal and credit information. A much stronger provision to require banks to get their clients' consent prior to disclosure was defeated. It is essential that, if the House bill is enacted, the rules implementing it order banks to spell out their **privacy** policies clearly and conspicuously and make it as easy as possible for customers to opt out.

House enactment of an "opt-out" clause depends on whether Rep. David Dreier (R-San Dimas), chairman of the Rules Committee, will allow the Commerce Committee amendment, rather than a much weaker Banking Committee proposal, to be considered by the full House. Consumers should let Dreier know where they stand.

*

To Take Action: Rep. David Dreier, (202) 225-2305 or click on "Feedback" at the Web site http://www.house.gov/dreier.

LANGUAGE: English

LOAD-DATE: June 14, 1999

FOCUS™

Search: General News;Privacy, Los Angeles Times

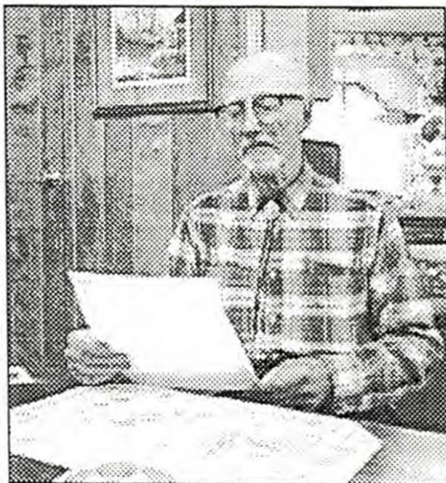
To narrow this search, please enter a word or phrase:

FOCUS

Example: **House of Representatives**

CNBC & The Wall Street Journal Business
CNBC FILE

MSNBC HOME
- News
- Business
- Sports
- Local
- Health
- Technology
- Living · Travel
- TV News
- Opinions
- Weather
- Shopping
- MSN.COM


CNBC

Albert Newman, 79, couldn't figure out why he was getting mail from an insurance company for a policy he didn't want. But he traced it to his bank -- and is now suing for invasion of privacy.

Privacy advocates targeting banks

States eye tighter rules on how information is shared

By Sharon Epperson
CNBC

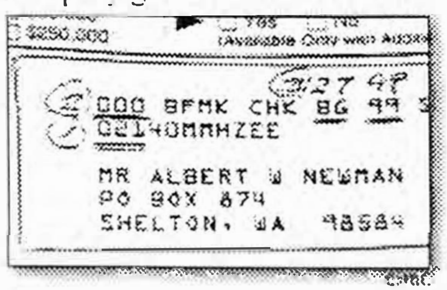
Aug. 3 — It's amazing how much personal information businesses require consumers to provide just to make a simple transaction, like rent a movie or order take out. But banks maintain a much deeper, richer trove of personal information on their customers — who probably assume it's all under lock and key. Don't bank on it.

COMPLETE STORY

'I think more onerous things kinds of things will occur in the future if we don't nip it in the bud now.'

— **CHRISTINE GREGOIRE**

Attorney General, Washington state



Newman used his cryptography experience to decode a mailing label -- and found it matched his checking account number.

YOU MAY THINK your personal information is private. But banks know how much you make, what you spend it on, your Social Security number, your credit history. Things that even your friends and family don't know about, your bank does. And it may be sharing that knowledge with others.

"I was dumbfounded, disgusted, upset," said 79-year old Albert Newman, who, like many consumers, was unaware that his bank could give out his personal financial information. Five years ago, Newman started receiving mailings from an insurance company for a policy he didn't want. At first, he had no clue how the company got his name or address.

But then Newman, a cryptographer in World War II, put those skills to work. He decoded the digits on the upper right hand corner of the insurance pitch — and discovered it was his checking account number.

"The cat was out of the bag," said Newman.

Newman is now suing Washington state's Heritage Bank for breach of contract, invasion of privacy and violation of the Consumer Protection Act. He says he wants the bank to "admit that they're doing something that the average individual doesn't understand or know about."

Heritage Bank officials denied selling any information to marketing firms but admit sharing "confidential and private information " with some financial service providers.

Right now, it is only illegal for a bank to sell someone's credit report to a third party like a direct marketer. But any other information can be fair game. Newman's attorney says until laws are changed, the scales of justice are tipped in the banks' favor.

"We have asked the attorney general's office to change the Consumer Protection Act to provide that disclosure of private financial information would be a per se violation," said public interest attorney Shawn Newman (who is no relation to his client).

Washington state Attorney General Christine Gregoire agrees that swift action needs to be taken.

"I think more onerous kinds of things will occur in the future if we don't nip it in the bud now," she said.

What you can do

Privacy experts says there are a few things you can do to keep private information private:

If you order a catalog or magazine, ask the company not to sell your name.

If your name has already been sold, ask for the list of businesses or charities that bought it and ask them to put you on their "do not mail" lists.

To remove your name from marketers' mailing lists, write to the Direct Marketing Association's Mail Preeference Service, Box 9008, Farmingdale, N.Y., 117835-9008

For phone lists, write to the DMA's Telephone Preference Service, PO Box 9014, Farmingdale, N.Y. 11785-9014

Write to credit reporting agencies and ask to "opt out" of the pre-approved credit lists they sell to companies. Or call 888-567-8688.

A rash of consumer complaints compelled the Attorney General to create a new privacy task force.

"This is an issue that effects every single citizen of this country; the right for them to have their information protected," said Gregoire. "And the right for them not to allow someone to sell for commercial purposes their personal, private information without their consent."

Gregoire played a pivotal role in the recent successful fight of various state attorneys general against the tobacco industry. She says this battle is even bigger.

"This issue has a more far reaching potential problem for consumers and has caused much greater fear for consumers than any other case that I have dealt with," she said.

TAKING ACTION

The state of Washington is not alone in its fight to protect consumers' privacy. Government officials across the country are investigating banks' practices, and one state has already taken legal action.

U.S. Bancorp recently paid $3 million to settle a lawsuit waged by Minnesota's attorney general. The suit alleged that the bank released customer information to a telemarketing company for $4 million, plus commissions.

The bank said it would stop disclosing consumer information to most marketers, except those that sell financial products. Soon after, other banks, including Chase Manhattan and Wells Fargo, imposed similar restrictions.

The suit has heated up the debate at a time when Congress is divided over whether to add privacy provisions to banking legislation.

"What I have proposed is that we complete our hearings on privacy, do some in-depth study and write a financial privacy bill," said Sen. Phil Gramm (R-Texas).

BREAKING BARRIERS

But some fear that current proposals, like Gramm's financial modernization bill, will break down barriers between banks and other financial services firms — making it easier for them to share information.

Consumer advocates worry that in the era of mega-mergers like the Citibank-Travelers deal, a bank could, for example, deny a mortgage loan if it learned from its insurance affiliate that the customer was seriously ill.

But the banking industry maintains that such sharing of information can be an asset.

"Consumers actually benefit in the way of lower prices and greater convenience when limited information is shared about them within a bank's family," said Sonia Barbara, with the consumer's division of the American Bankers Association.

But if consumers don't see the benefit, the industry's trade group says they should let their bank know.

So that's what Albert Newman is doing. He has refused to settle his case: he wants his message heard loud and clear.

"There's no one with the temerity to say, 'Let's go get em.' I'll do that," he said.

Many banks claim customers can simply write to request their names be taken off any sales lists. But consumers groups suggest banks adopt "opt-in" provisions, in which customers would only receive outside materials if they opted to be included on these lists.

MORE LINKS
MSNBC not responsible for content of Internet links
INTERNET Direct Marketing Association

TOP BUSINESS NEWS
STORY Microsoft-AOL war heats up over plans for Internet access
STORY U.K. leaves rates at 22-year low
STORY Cardinal Health in $390 million deal
STORY Free PCs: a win-win or a win-lose?
STORY Just how low can Internet stocks go?

MSNBC VIEWER'S TOP 10

Would you recommend this story to other viewers?
not at all **1 - 2 - 3 - 4 - 5 - 6 - 7** highly

TOC: More Stories from this May 1999 issue

Latest Issue Online

Archives & Back Issues

Themes & Sections

Search Fast Company

"This is a Marketing Revolution"

by Charles Fishman
Photographs by Peter Ross

first appeared: Fast Company issue 24 page 204

Capital One is winning big in the cutthroat world of credit cards by changing the rules. Its mission: Deliver the right product, at the right price, to the right customer, at the right time. Its method: Never stop testing, learning, or innovating.

The telephones at Capital One Financial Corp. ring more than one million times a week. People call to ask about their MasterCard balance, or whether a recent payment was received, or why their interest rate has jumped. And more than 1 million times a week, here's what happens -- before a caller hears the first ring:

The instant the last digit is punched, high-speed computers swing into action. Loaded with background information on one in seven U.S. households and with exhaustive data about how the company's millions of customers behave, the computers identify who is calling and predict the reason for the call. After reviewing 50 options for whom to notify, the computers pick the best option for each situation. The computers also pull and pass along about two dozen pieces of information about the person who is calling. They even predict what the caller might want to buy -- even though he or she isn't calling to buy anything -- and then they prepare the customer-service rep to sell that item, once the original reason for the call has been addressed.

All of these steps -- the incoming call, the data review, the analysis, the routing, and the recommending -- happen in just 100 milliseconds. That's one-tenth of a second, or one-eighth of the time that elapses between beats of a human heart.

Make no mistake: Capital One has some wicked-fast computers. And its growth rate has been nearly as fast. The company took shape in 1994, when it began as a spin-off of Signet Banking Corp. It now ranks among the 10 largest issuers of credit cards in the United States, with 16.7 million customers (it added 5 million new accounts last year alone) and total balances of $17.4 billion. Its stock chart looks more like that of an Internet startup than like that of a bank. Stock in the company, which was first offered at $16 per share, has traded as high as $140. The company, with 11,000 employees, has a market value of more than $7.8 billion.

Capital One's cofounders -- a pair of buddies with no previous hands-on experience in the banking industry -- had rocked the credit-card world while they were at Signet, where they had invented the "teaser rate" card and the "balance transfer" option. Those two innovations sucked millions of customers away from established companies, and the two men brought them over to their own company. The real secret of Capital One's success, though, has been its commitment to endless innovation. Lots of companies claim that they compete on knowledge. Capital One has enough information on consumers to fill the hard drives of more than 200,000 personal computers. It uses that information much as a physicist uses a particle accelerator: Cap One analysts and product managers come up with an idea for a product, bounce the data a bit, test it, tweak it, and launch it as fast as possible. In other words, they use the scientific method to design credit cards.

"Credit cards aren't banking -- they're information," declares Rich Fairbank, 48, chairman and CEO, whose father is a physicist. "When we started this company, we saw two revolutionary opportunities: We could use scientific methodology to help us make decisions, and we could use information technology to help us provide mass customization."

Says Nigel Morris, 40, Cap One's president and Fairbank's alter ego: "Very few companies have the ability to test and learn." But those twin capabilities -- testing and learning -- form the foundation on which Capital One is built. The company tests every product offering, every procedural change, every job applicant. It keeps records on every customer interaction and on every card purchase, and, with the patience and persistence of a good scientist, it runs experiment after experiment. "For every action we've taken," says Jim Donehey, 50, Capital One's chief information officer, "we know what the reaction has been. If we sent out a blue envelope and a white envelope, we know which envelope went to which customer -- and we've recorded what the reaction was in each case."

For example, Capital One started selling things (insurance, long-distance service, buying-club memberships) to customers who called -- after tests showed that people prefer to buy things when they call Capital One, rather than when Capital One calls them. Today half of all new Cap One customers buy something (other than a credit card) within their first year as a customer.

Last year, the company performed 28,000 experiments -- 28,000 tests of new products, new advertising approaches, new markets, new business models. As a result, it can deliver the right product, at the right price, to the right customer, at the right time. It offers 6,000 kinds of credit cards, each with slightly different terms, requirements, and benefits, and each requiring a slightly different monthly statement. Some credit-card holders have a no-fee Mercedes-Benz affinity card with a credit line of $20,000. Others pay $29 a year for a card with just $200 worth of credit. Some have a credit card with a Canadian moose on it. Others have a card with a map of Japan and an image of Mt. Fuji on it. One reason why Cap One has attracted millions of customers is that it's able to present itself a little differently to each of those customers.

"What we've done," says Fairbank, "is to create an innovation machine." That machine has just begun to kick into gear. "This is not just a credit-card strategy," Fairbank insists. "This is a marketing revolution that can be applied to many businesses."

For Fairbank and Morris, the credit-card business has been a grand experiment in using information technology to figure out what people want to buy and how Capital One can sell it to them. Says Jory Berson, 28, vice president of marketing and analysis at Cap One: "I want us to become the place where people go to find anything they want to buy."

"We can answer your question before you ask it."

Joe from Florida is a tough call -- a confused older man, the holder of a MasterCard with a $100 credit limit. He informs his phone rep, Tim Gorman, 29, that he knows what happened the last time he called Capital One: "I've got it written on the wall right next to the phone," he says.

Nancy from North Carolina is easier. A moment after her voice materializes in Gorman's earpiece, information about her credit card pops up on his computer. Nancy is a desirable customer: She has a $6,500 credit limit on her Visa, she's been a Capital One customer for four years, she pays no annual fee, and she hasn't paid late in the past 12 months.

Her opening line: "I want to close my account."

Gorman is used to that greeting. He works as a Capital One "retention specialist," and all of the calls routed to him are from people who say they want to close their account.

Gorman knows better. Most of them just want a better deal.

"I just got a card with a 9.9% interest rate," says Nancy, "and that's a lot lower than my current rate."

Nancy's current rate is 16.9%. Gorman's computer displays three counteroffers that he can make in an effort to keep her business. Those offers have different interest rates -- starting with 12.9% and ramping down to 9.9%.

"Well, ma'am, I could lower your rate to 12.9% . . ."

Nancy grabs the first deal that Gorman offers, and Gorman scores a "save." Is he concerned that Nancy didn't get the best deal available? Not really. "Who's to say she really was offered a 9.9% card?" he says. "Maybe that was just something that she saw or something that came in the mail." Nancy is happy, Capital One is happy, and Gorman has earned incentive pay for keeping her -- plus a little extra for getting her to take a deal that preserves much of Capital One's revenue.

Superficially, Gorman's exchange with Nancy sounds like what happens at credit-card companies everywhere. It's standard these days for account information to pop up when a call comes in (computers identify the account by linking it to a phone number), and many companies bargain over interest rates and fees. But at Capital One, that's where the interaction begins, not where it ends. The history of "intelligent call routing" (a term that Capital One coined) -- with its tiers of computer-enabled decision making -- is a case study in how a culture of innovation can take small problems or modest ideas and turn them into breakthroughs.

In this case, the problem had to do with the phone bill. Two years ago, calls from Capital One customers were taking too long to handle, and an analysis showed that customers were not to blame. Callers simply weren't getting to the right place at the right moment: People with a lost card or a fraud problem ended up reaching an ordinary rep; people who just wanted to know their balance stayed on hold to talk to a live rep; people unhappy with their interest rate called the "lost card" number on the back of their card and had to be transferred to customer service.

"All that time -- to take a call, to bridge the call to the right person -- that pisses off the customer," says Greg Gannon, 44, a technology manager who was brought in to look at the problem. "You wait for an agent, you wait for a transfer, you wait again for an agent."

Plus, says Jim Donehey, "All that time, we're paying for the call." Companies pay by the second, and at a place like Capital One, which takes 2.5 million live calls a month, even one extra second per call adds up to real money. "The real question was, How can we minimize all that?" says Donehey.

The company tried lots of options. For example, it discovered that some people called much more often than the average of five times a year. "We sent out a letter at one point that said, in effect, 'Please don't call so much,' " says Donehey. That test yielded this result: If you want people to call you, send them a letter telling them not to. "That was what I call 'a Homer Simpson moment.' "

The ultimate solution -- suggested by the technology folks -- had less to do with an animated character than with artificial intelligence: Why not predict the reason for each call and then send that call to the agent who is best able to handle it? In fact, a company like Capital One, with 3,000 people answering calls, knows plenty about why customers reach for the phone: Ninety percent of all calls fall into 1 of 10 categories. Raise your customers' interest rate, and they call. Put an automatic fraud stop on their card, and they call. Send out a new card that needs to be activated, and they call. Some people call once a month to find out their balance; some people call three times a month.

It took months to analyze these calling patterns, to figure out which events in a customer's credit-card life would predict a call. Decision-tree software had to be written, equipment had to be bought, phone switches and computers had to be taught to talk to each other. Along the way, people working on the project arrived at some powerful insights. For example, customers who call each month to check their balance or to see whether their payment has arrived could be identified and routed to an automated system that answers the phone this way: "The amount now due on your account is $364.27. If you have a billing question, press 1. . . . " Or: "Your last payment was received on February 9. If you need to speak with a customer-service representative, press 1. . . . " The genius of this system, says Donehey, is that "we can answer your question before you ask it." A phone call that might have taken 20 or 30 seconds, or even a minute, now lasts just 10 seconds. Everyone wins.

A routine problem in search of a quick solution led to a new way of doing business. Today customers get where they are going immediately, and they get the information that they need quickly. Customer-service reps handle those calls that need to be handled by people, and they don't waste any time passing calls to colleagues. For example, customers who have received prototype products are automatically routed to staffers who know about those products.

This calling system has become a competitive advantage for Capital One, making possible both lower costs and better service, and the company is understandably reluctant to share specific performance data about it. But a few round figures are available: The system went into effect last June, and, says Donehey, "Within a few months, it was right 40% of the time." Gannon says the prediction-success rate is now at 60% to 70%.

And the system just keeps getting smarter. Do you routinely call from your boyfriend's phone -- the number for which is not on file at Capital One? Eventually the computer will figure out that his number should be associated with your account. If you call to close your account, you'll encounter a subtle measure of what Cap One thinks of your business -- because the system will do a real-time analysis of your value as a customer. People worth keeping are routed to a live agent like Tim Gorman. People whom Capital One is not unhappy to be rid of are routed to a voice-response unit and allowed to close their account using their Touch-Tone phone. Meanwhile, more capabilities are in development. For example: The system will learn what language each customer prefers to do business in and then route calls accordingly.

"This started as such a simple problem," says Donehey, "but IT enabled us to go back to the business side with a solution that went beyond solving that problem. The flow of information between IT and the business side and the customer is constant. A lot of the stuff that really makes our technology work has nothing to do with technology -- it has to do with attitude."

"Every interaction is a selling opportunity."

Larry from Pennsylvania is on the line, baffled by his new Capital One "Silver" Visa, with its $1,000 limit and its $59 annual fee. The card comes with coupons offering discounts on hotels and rental cars, but Larry can't figure out how they work.

Barbara Brannon, 57, a veteran customer-service rep and one of Cap One's telephone stars, talks to Larry as if she has nothing else to do. She concedes that the Silver Visa carries a fee that's $20 higher than that of Larry's former card, a regular Visa. But, she says, "you can get that back with a single discount at a single hotel."

Once Brannon has helped Larry understand his new card, she says, "Sir, do you do any catalog shopping?"

"No."

"Are you interested in any kind of interior-design shopping?"

"Catalogs?" Larry asks.

"It's like the Silver Visa," says Brannon. "It's a service that we offer -- Capital One Interiors. It's a catalog with a lot of coupons. If you order it, you'll pay for it by the second or third time you use it."

"Thanks just the same," says a suddenly lucid Larry. "I get enough junk mail already."

Brannon is a star -- not just because she understands how to handle routine credit-card confusion, but because she is an unerring saleswoman as well. After all, why not try to sell a guy who is confused about coupons more coupons?

On a typical day, Brannon sells something to roughly 15% of the customers who are routed to her. Using an analysis of each customer's buying habits and demographics, her computer terminal automatically tells her which products to offer. Whether Brannon makes an offer on a particular call is up to her. With customers who are particularly upset or who are being transferred to another department, she doesn't. On this winter evening, though, she's scoring a sale with one out of every three callers. "I don't shove it down their throats," says Brannon. "I throw it out if it's something that I think they might like."

A woman from Miami, who has called to find out if she has to pay her $39 annual fee every year, cheerfully signs up to pay $59.95 a year for Privacy Guard, a service that helps you check your credit report. "That's called a sale!" says Brannon. "That's called fattening your paycheck. Give me more calls!"

Esther from Connecticut, who had called to check her current interest rate, signs up to pay $59.99 for Capital One Edge, a program in which you receive a catalog of discounted merchandise as often as 12 times a year.

Carolyn from Illinois, whose credit history has won her a Visa with a $200 limit and a $59 annual fee, calls to find out how to get a cash advance. After answering that question, Brannon warns Carolyn that her Visa has less than $100 of credit available. Then she offers Privacy Guard to Carolyn. The cost: $59.95. "If you want to get your credit report, this is the way to do it," Brannon says. "This is what you need." (Actually, if your Visa has a $200 limit and a $59 annual fee, you don't really need a credit report.) Says Carolyn: "Yes, I would like to try that."

No one at Capital One can recall whose idea it was to sell things to customers when they call the company, rather than the other way around. Most credit-card companies, including Capital One, have long tried to "cross-sell" their customers -- often by using inserts in monthly statements to tout everything from calculators to cruises.

The idea to add a new twist came, naturally, through data analysis. "It happened three or four years ago," says Nigel Morris. "We were doing outbound telemarketing, calling at dinner time, and we looked at the statistics on who bought things, who told us to get lost, and who bought things that they never used. We thought, 'This isn't working that well. What if we talk to people when they call us?' "

For Morris, a transplanted Brit who vibrates with energy and who has a mischievously contrarian streak, it seemed like a natural: "Gosh, if you call me and I'm trying to sell you something, then I'm going to treat you very nicely. That's going to promote better service. But people said, 'Service people are not salespeople. The systems don't exist to do this -- to service people and sell them at the same time. And anyway, even if you could do it,' they said, 'you would never sell enough to make the longer phone calls worthwhile.' People said it couldn't be done. That's all the motivation we needed."

In the case of inbound cross-selling, the first test product was easy and sweet. New customers must call an automated line to activate their card. "We thought, 'That's the perfect time to sell them something,' " says Jory Berson, who is in charge of cross-sell opportunities at Capital One. "The first thing we sold was a balance transfer: 'Now that you've got our card, is there any debt that you want to transfer to us?' " While customers waited on the line for a computer to verify and activate their card, they could sign up to move balances from other cards onto their new account.

Customers loved it. Or, at least, they bought it.

The response was so enthusiastic, relative to Cap One's effort, that Berson began looking for other products that Capital One could sell in this way. "I don't have a big desire to sell you groceries, because once I have to ship stuff, I can't save you any money," he says. "But auto insurance -- I can sell that cheaper. Mortgages, long-distance service, auto loans, cellular service -- same thing."

Berson sat down with his partners -- Eric Nelson, 30, Cap One's IT director, and Marge Connelly, 37, who runs all of the company's call centers. At their first meeting, in the wake of the balance-transfer experiment, "the brainstorming was less about 'Is this a good idea?' than about 'How do we do it as quickly as possible?' We weren't trying to pretend that this is rocket science," says Berson.

Indeed, the biggest hurdles were human. "At first blush," says Connelly, "folks look at the idea of selling to someone who's calling, and they say, 'There's a conflict between servicing and selling.' Some associates said, 'I don't feel good about making this offer to customers.' We were listening, trying to appreciate that feeling."

The solution, says Connelly, was "to elevate this beyond the immediate transaction level. If I'm a phone associate, my mission is to meet my customer's needs. And people have a pretty wide range of needs. If I've got this great product, it might save a customer some money, or it might create convenience. If I'm committed to service, there's no way I'm not going to consider offering that product."

Within three months of that first brainstorming session, live reps started fielding calls during which they both serviced and sold. Today Cap One does almost every cross-selling effort in partnership with another company. It makes a deal to market a product: The Hartford provides the insurance, MCI provides the long-distance service, Damark International provides the catalog clubs.

"The creativity comes in how we do that," says Rich Fairbank. "We do three things that other companies in the industry don't do. First, every interaction is a selling opportunity -- although I don't want to give the impression that we can't wait to get through your problem before we try to sell you something. Second, it's done in an information-based way: What's sold and how it's sold are decided statistically, according to information that we have. And third, we are totally committed to selling products that are of very high value. I say this with passion, because it's easy for companies to trap themselves into selling low-value things."

(For his part, Jory Berson says that he "feels better" about the auto-insurance offering, the mortgage deal, and the long-distance service than he does about Privacy Guard or about the catalog memberships. But even the latter, he says, "are presented fairly, at a fair price -- usually a lower price than other issuers offer.")

What ultimately kicked Cap One's cross-selling into high gear was Greg Gannon's intelligent call-routing system. It was a perfect fit: The same computer that predicts why you're calling can also predict what product you might want to buy. In fact, where your call gets sent often has as much to do with what Cap One wants to sell you as it does with how you will get your question answered.

Customers who are judged most likely to buy are sent by the computer to Cap One's most skilled sellers -- to Barbara Brannon's group. Every one of the three dozen non-credit-card products that Capital One offers has a statistical model behind it that outlines which kinds of customers will find it most appealing, and under what circumstances. A specific "product offer" comes to a customer-service rep in the same data burst as a caller's account information. So the decision about what to offer is made the instant someone calls. "It's got to be real-time," says Berson. "If normally I'd sell you long distance, but you're calling because you lost your card, I'd be a fool not to sell you credit-card registration."

Capital One doesn't reveal how much of its revenue or profit comes from non-credit-card sources. "It's a huge part of our business," says Berson. "We now make more than 1 million sales in a year through customer-service marketing -- not including inserts, or telemarketing, or automated calls." Those sales occur during the 30 million live calls that Capital One handles each year. In 1998, for the first time, half of all new Cap One customers bought another product from the company within 12 months of signing up for their credit card. "That's amazing penetration," says Berson, "and it leads to tremendous profitability."

"A cell-phone is just a credit card with an antenna."

When is a credit-card company not a credit-card company? That's the question now facing Capital One. If the company can serve its customers faster and smarter than its competitors can, if it can sell products unrelated to credit cards, then why continue to think of itself as a credit-card company at all?

According to cofounders Fairbank and Morris, Capital One's real capital resides in the hundreds of terabytes of data that the company has collected on the behavior of current and potential customers, and in the vast testing experience of its analysts, who know how to figure out what really matters to (and about) those customers. The company's knowledge base positions Capital One to tackle all kinds of other information-rich businesses.

Already, a Capital One subsidiary, America One, is selling cell-phone service in much the same way that the mother company offers credit cards -- by offering a slightly different deal to each type of customer. (Quips Morris: "A cell-phone is just a credit card with an antenna.") Cap One doesn't confuse its customers with choices. Instead, it tries to figure out what its customers will want. "Our secret," says Fairbank, "is that we are trying to deliver very simple solutions to the customer."

Fairbank claims that within two or three years, most people will know Capital One for reasons other than its credit-card business. "Fifty percent of what we're marketing now did not exist at this company six months ago," he says. "And 95% of what we're marketing today didn't exist two years ago. I'm proud of that fact -- until I reflect on its implications. It means that 50% of what we'll be selling six months from now doesn't exist yet."

Says Jory Berson: "We're becoming a company that people can turn to for just about anything. When you get ready to buy a car, the first thing I want to go through your mind is, What kind of deal can Capital One get me on an auto loan or on auto insurance?"

What about the car itself? "Oh, sure," he says. "A car-buying service is on my list."

Sidebar: What's the Hard Part? Innovation Never Ends

Capital One scored some early victories in the credit-card game by changing the rules. Its founders invented the "teaser rate" -- the banking equivalent of a cheap mortgage that gets adjusted up after a certain period. The teaser attracted millions of customers, and eventually competitors began to mimic the idea. The result was a merry-go-round of so-called teaser hoppers. People would move their balance to a low-introductory-rate card; as soon as the rate expired, they would switch to another card. Over time, Cap One was being eaten alive because of customer attrition.

The lesson: Companies that thrive on change can never rest. Competitors are quick to copy good ideas. The way to compete on innovation is to keep innovating.

That's the hard part. And that's why Capital One is so obsessed with making its own innovations obsolete. Consider the teaser rate. "Customers have gotten smarter about this game," says Dan Friedman, 29, a credit-card product manager. "But customers don't want to play it." What do they want? People want a simple card with a good rate, says Friedman. So, for two and a half years, Friedman's team offered prototype no-fee, fixed-rate cards to a wide spectrum of Americans. The cards had slightly different rates, slightly different credit limits, slightly different terms: "We were doing at least a dozen tests each quarter."

The team absorbed data about which rates appealed to which kinds of customers, about how customers used the new cards, and about which set of factors produced the most profitable card. "We found a rate at which we got good loyalty and low attrition," says Friedman. "That's what we wanted." There was just one problem: The card wasn't profitable.

"That is where smart people come into play," says Friedman. Two of Friedman's analysts concluded that they needed to attract customers who were better credit risks -- in other words, people who defaulted less often. "They suggested different underwriting standards. As soon as we had that hypothesis, we could test it with data that we already had."

The result of all this experimentation: Early in 1998, Capital One began offering a permanent, fixed-rate card to a select group of customers. The card has a fixed annual rate of 9.9% and no annual fee. The company that changed the game with the teaser rate is changing it again. Today, in fact, Cap One doesn't even offer a teaser-rate card to new customers.

Sidebar: Testing, Testing

At Capital One, the essence of innovation is experimentation. Every idea for a new product starts with a test, or a series of tests. If a test succeeds, the company ramps up fast.

Each test offer is handled by a small group of reps, whose opinions about the products are also taken into account. Cap One tracks not only whether people buy something but also whether they use it. The company has shelved products that customers didn't buy or didn't use. Selling software didn't work. Neither did selling mutual funds (although plans are under way to launch another mutual-funds sales program). Behind every test is a three-person team: someone from marketing, someone from operations, someone from IT. There are no silos at Capital One. Each business unit has a "business information officer" who is responsible for making technology work in that unit.

Testing doesn't apply only to products. Cap One hired more than 100 people a week in 1998, but it doesn't conduct anything resembling routine job interviews. Instead, applicants take tests, sit through guided interviews, and do role-playing exercises. In the case of customer-service reps, supervisors never even meet candidates; they meet only the people who get hired. "We found out that interviews by line managers didn't predict job performance at all," says Dennis Liberson, 43, the company's HR chief. That discovery was made, of course, through follow-up testing -- through comparing actual performance of employees with what their supervisors had predicted when they were first hired.

This year, 1,000 of Capital One's 11,000 employees will sit down to take tests. HR has developed 10 new pre-employment tests, and it wants to see how good they are. It will administer those tests to selected current employees, who will in turn have their job performance evaluated. Test results will then be anonymously correlated with how well those employees do their work. "We think these tests will predict certain competencies," says Liberson. "But before we start using them, we want to make sure."

In other words, the testers have a new test that they need to test. The company's testing culture is so deeply intricate, so wound around itself, that a senior executive recently pointed to an M.C. Escher print in his office -- a print of people climbing or descending a series of interlocking staircases -- and laughed: "That's our organizational chart."

Capital One sometimes thinks so hard about what it does -- and tests its ideas so thoroughly -- that the whole system can make an outsider's head hurt. But most people at Capital One will tell you that testing does not give them a headache: Rather, it opens their minds to new ideas. "Testing," declares Wendy Alexander, 29, international product manager, "liberates you from conventional thinking."

Charles Fishman (cnfish@mindspring.com), a Fast Company contributing editor, is based in Raleigh, North Carolina. He scored 40 out of 40 on Capital One's management-screening test. Even so, the company rejected his application for a no-fee, 9.9% MasterCard. Visit Capital One Financial Corp. on the Web (http://www.capitalone.com).

Privacy Policy of Top Ten Banks (by assets) posted on Web Site

Privacy 🔒 or **Piracy** ☠ **?**

	Opt-Out: Companies *can* disclose unless Consumers say *No*			Opt-In: Companies *cannot* Disclose unless Consumers say *Yes*	
	Affiliate Sharing		Third Party Sharing	Affiliate Sharing	Third party Sharing
	Only Credit Report Information (FCRA required)**	All Financial Data			
NationsBank	🔒	☠	🔒✔	☠	☠
Citibank	☠	☠	🔒✔	☠	☠
Chase Manhattan	☠	☠	☠	☠	☠
Bank of America	🔒	☠	🔒✔	☠	☠
First Union	🔒	☠	☠	☠	☠
Morgan Guaranty Trust	No Privacy Policy Available				
Bankers Trust	No Privacy Policy Available				
Wells Fargo	🔒	☠	🔒✔	☠	☠
Fleet	☠	☠	☠	☠	☠
First Nat'l Bank of Chicago (BankOne)	☠	☠	☠	☠	☠

KEY:

🔒 Provides privacy policy listed

🔒✔ Limited privacy policy, e.g., only opt-out on marketing lists

☠ Does not disclose or provide privacy policy listed on web site; may, however, have additional policy in mailings to customers

** Opt-out for credit information is consistent with that required under the Fair Credit Reporting Act

Consumers Union & US Public Interest Research Group (US PIRG) – June 1999

Use and Sharing of Information outside Our Affiliated Family of Banks and Companies

We maintain procedures designed to protect confidential information about you (and your products and services with us). Other than under the limited exceptions explained in this brochure, it is our practice not to share confidential customer information outside our affiliated family of banks and companies. You do not need to request this confidentiality – it is our standard practice.

The limited exceptions under which we share confidential customer information with parties outside our affiliated family of banks and companies apply only when we are *legally required* to share this information or when we are *legally permitted* to share this information to serve your interests or to address legitimate business concerns. (See Question and Answer #6 below.)

QUESTIONS AND ANSWERS ABOUT OUR USE OF INFORMATION

OUR INFORMATION ABOUT YOU

Question #1: *Why do you want to know about me?*

Answer #1: One of the main reasons we gather information about you is to protect you. We need to be able to identify you and your products and services to prevent access to personal and financial information by unauthorized persons.

We also gather information to help us understand your financial needs and provide you with quality products and services. For example, if we know you own your home, we know that a home equity loan may be a better alternative than an installment loan to finance your next purchase – because of possible tax benefits.

In some cases, we also gather information to help us design or improve our products and services. For example, information obtained from customers can tell us whether to develop a new type of home mortgage or checking account. This type of information enables us to identify the needs of customers and provide services to meet those needs.

Finally, we also gather information to comply with laws and regulations that govern the financial services industries. For example, federal regulations require that we obtain a social security number or tax identification number for many types of accounts, such as bank deposit accounts that pay interest.

WELLS FARGO

USE AND SHARING OF INFORMATION WITHIN OUR AFFILIATED FAMILY OF BANKS AND COMPANIES

Question #2: *How do I benefit when you share information about me and my products and services with you within your affiliated family of banks and companies?*

Answer #2: We provide products and services to customers through a number of separate banks and companies. By allowing our affiliated banks and companies to share information about you and your products and services with each other, you enable us to serve your total financial needs. You may receive our combined bank/company account statements, easier access to certain account features, new or enhanced products, special promotional offers, and certain discounts that you might not otherwise know about or be eligible to receive.

Question #3: *If I request to be excluded from affiliate sharing of information as explained in the front cover, will all of your affiliated banks and companies honor this request?*

Answer #3: When we process your request, all of our affiliated banks and companies will honor your request, although certain information about you and your products and services with us still may be shared (as explained in Questions and Answers #4 and #5 below). You cannot selectively request to be excluded on a company-by-company basis or product-by-product basis.

Question #4: *If I request to be excluded from affiliate sharing of information, what information about me and my products and services with you will and will not be shared within your affiliated family of banks and companies?*

Answer #4: This is a complex question because the Fair Credit Reporting Act and certain other laws permit you to direct us not to share *certain* information within our affiliated family – but these laws also permit us to share certain *other* information within our affiliated family. Even if you "request to be excluded from affiliate sharing of information," we will share this *other* information about you and your products and services with each other to the extent permitted by law, as discussed below.

Fair Credit Reporting Act

The Fair Credit Reporting Act is the primary law that covers information sharing within our affiliated family of banks and companies. This Act permits our affiliated banks and companies to share with each other the following types of information: identification information about you; information about your transactions with any of our affiliated banks and companies; and information about the experiences of any of our affiliated banks and companies with you.

Except for this identification, transactional, and experiential information, when you request to be excluded from affiliate sharing of information in accordance with the procedures set out in the front cover of this Use of Information brochure, we cannot share information about you and your products and services with us from your applications or agreements, from credit reporting agencies, or from other sources when the communication of this information would be classified as a "consumer report" under the Fair Credit Reporting Act. The Fair Credit Reporting Act, however, does not prohibit us from sharing this information within our affiliated family of banks and companies in other circumstances.

Other Restrictive Laws

Other laws and rulings also regulate our ability to share *certain* information within our affiliated family of banks and companies in particular circumstances or to offer you products and services in particular cases. Some laws, for example, prohibit us from sharing certain information within our affiliated family of banks and companies without your express written or oral consent or, in a few cases, under any circumstances. Whether or not you have provided us with a "request to be excluded from affiliate sharing of information," of course, we abide by these laws.

Question #5: *Can you provide me with a few examples of information that still may be shared within your affiliated family of banks and companies if I request to be excluded from affiliate sharing of information?*

Answer #5: In virtually all cases, we can share identification information about you, such as your name and address. In most cases, we also can share information about your transactions or experiences with any of our affiliated banks and companies, such as your loan repayment or checking account history, ~~as permitted under the Fair~~ Credit Reporting Act.

When we service your accounts, we can share a great deal of additional information solely for that purpose. Some of our affiliated banks and companies, for example, share or receive information to provide technical or operational support services – such as to prepare your account statements or provide data processing services – for other affiliated banks and companies.

USE AND SHARING OF INFORMATION OUTSIDE OUR AFFILIATED FAMILY OF BANKS AND COMPANIES

Question #6: *Under what circumstances do you provide information to parties outside your affiliated banks and companies?*

Answer #6: Although we are committed to protecting our confidential information about you and your products and services with us, occasionally it is necessary to provide some of this information to parties outside our affiliated banks and companies.

We are required, for example, to share information about you and your products and services with us with parties named in a lawsuit or administrative action when we are served with a subpoena or court order. We also are required to share this information with federal or state regulatory authorities, such as banking examiners or the Internal Revenue Service, as authorized by federal or state law. Consistent with the practice of other banks and financial services companies, we also share certain information about you and your products and services with us with reputable credit reporting agencies as authorized by federal law and with others who may receive certain information from us under particular circumstances – *but only as lawfully permitted or required.*

From time to time, we contract with parties outside our affiliated banks and companies in order to make available to you certain services or products. For example, we may contract with insurance companies to make available to you various insurance products. We also sometimes contract with outside agents or service providers to prepare your account statements, enter or calculate transactions and balances, or provide other materials or services on our behalf. These agents, service providers, and third party product providers agree to safeguard our information about you and your products and services with us and must abide by applicable law.

We also occasionally decide to sell business assets or a business line, such as mortgage servicing rights. In these cases, we may transfer to the purchaser the related customer information.

The "Deposit Account Agreement" or the "Customer Disclosure Agreement" for our affiliated banks tells when the bank will disclose account information to third parties. Our affiliated companies, while not required to provide this same disclosure, follow similar rules and provide information to such third parties only in appropriate circumstances.

Question #7: *Do you provide special treatment of information that your affiliated trust company or bank holds as my trustee or disclosed fiduciary, since I am particularly concerned about preserving the confidentiality of this information?*

Answer #7: Yes, any information about you within our trust division, along with your trust or agency accounts, is subject to special protection – even within our affiliated family of banks and companies. This information is considered extremely confidential.

OTHER QUESTIONS ABOUT THE USE AND SHARING OF INFORMATION

Question #8: *Is it possible that one of your affiliated banks or companies may solicit me for a product or service based on information received from an outside source?*

Answer #8: Like other financial services organizations, our affiliated banks and companies sometimes purchase mailing or other lists from outside agencies or companies that are in the business of compiling lists for purchase by others for their independent use. These lists are compiled by such agencies and companies primarily from public sources of information.

Question #9: *How can I remove my name from lists created by outside agencies and companies that are in the business of compiling lists for purchase?*

Answer #9: If you wish to have your name removed from the lists created by outside agencies and companies in the business of compiling lists, send a written request with your name, address and social security number (if issued) to the organizations listed below. These organizations are responsible for notifying the agencies and companies that are in the business of compiling lists that you wish to have your name removed from the lists they sell. Be sure to include all versions of your name that appear in mailings or in calls you receive. You must register your own name and address directly with each organization listed below since they cannot process any requests from us.

Mail Preference Service
c/o Direct Marketing Association
P.O. Box 9008
Farmingdale, NY 11735-9008

Telephone Preference Service
c/o Direct Marketing Association
P.O. Box 9014
Farmingdale, NY 11735-9014

The Direct Marketing Association will include your name in its consumer exclusion files so that your name may be removed from lists compiled or maintained by the agencies and companies that are members of that organization. Your name remains in the file for five years.

We hope that the provisions and explanations in this Use of Information brochure answer most of the questions that you have about our use and sharing of information about you. It is an important part of our continuing commitment to provide superior service to you, our customer.

NC 11251 MAJ (10 98 230827)

NORWEST

WELLS FARGO

USE OF INFORMATION

Use and Sharing of Information within Our Affiliated Family of Banks and Companies

To provide you with superior service and inform you of product opportunities and for other business purposes, the banks and companies affiliated with Wells Fargo & Company (which include Norwest banks and companies and Wells Fargo banks and companies) share information about you and your products and services among themselves. (See Questions and Answers #1 and #2 inside.) If you send us a written request that contains your name, address, social security number (if issued), your primary accounts or services with us, and your direction, such as "I request to be excluded from affiliate sharing of information," we will not share information about you among our affiliated banks and companies to the extent you may opt out of sharing under the federal Fair Credit Reporting Act and other applicable law. (See Question and Answer #4 inside.) Your written request needs to be mailed to Operations Center (M.S. 6058), P.O. Box 5110, Sioux Falls, SD 57117.

The provisions and explanations in this Use of Information brochure apply only to individuals. These provisions and explanations supersede all previous notices or statements with respect to the subject matter described in this Use of Information brochure. We reserve the right to change the provisions and explanations in this Use of Information brochure at any time. If you previously have informed Norwest or Wells Fargo of your request to be excluded from such affiliate sharing of information, you need not submit another request.

Nicole R. Rabner

08/06/99 11:30:36 AM

Record Type: Record

To: Katharine Button/WHO/EOP@EOP

cc:

Subject: IMPORTANT -- Idea for late August/Early September Event

For MV.

---------------------- Forwarded by Nicole R. Rabner/WHO/EOP on 08/06/99 11:30 AM ---------------------------

Sarah Rosen Wartell
08/06/99 11:21:23 AM

Record Type: Record

To: Jonathan A. Kaplan/OPD/EOP@EOP, Gene B. Sperling/OPD/EOP@EOP, Melissa G. Green/OPD/EOP@EOP

cc:

Subject: IMPORTANT -- Idea for late August/Early September Event

I would recommend that we do a radio address on privacy before Congress returns or around that time. We do not need to identify it with either the bankruptcy bill or fin mod. However, it will create uncertainty about our intent in both contexts and raise our leverage without committing us to insist on it in any specific context. We would not be making much policy news -- as on May 4th the President outlined our view and Gensler reiterated it before the Senate banking committee two weeks ago. However, he could say something like: "Congress has an opportunity this fall to provide financial privacy protections to Americans .... With so much change in the financial industries, with new technologies, we should not let the opportunity pass to make clear that we hold financial privacy dear ...." Gensler's testimony has good discussion of the legitimate expectation of privacy that Americans have, which we have found is violated ....

Consumer groups meeting with Melanne today also urged us to up the public rhetoric on privacy (while thanking us profusely for doing so much already). They think it will help make this a central issue in the bankruptcy floor debate. While that may be a good threat, I am not sure how likely that is. But regardless, it can't hurt our leverage in both bankruptcy and fin mod to have the issue lurking and some uncertainty about how much the president wants to ramp up the issue.

Melanne concurs that this is a good idea. In addition, Treasury staff could see no downside, although they had not consulted with Linda Robertson or Larry Summers.

The only downside I see will be how this interacts with any plans to do anything on medical privacy. I don't know where those discussions stand.

Also -- If not the radio address, the VP might be interested in doing something on this issue.