S. HRG. 110–1157

IMPROVING CONSUMER PROTECTIONS IN SUBPRIME LENDING

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

APRIL 29, 2008

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

75–345 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

DANIEL K. INOUYE, Hawaii, *Chairman*

JOHN D. ROCKEFELLER IV, West Virginia
JOHN F. KERRY, Massachusetts
BYRON L. DORGAN, North Dakota
BARBARA BOXER, California
BILL NELSON, Florida
MARIA CANTWELL, Washington
FRANK R. LAUTENBERG, New Jersey
MARK PRYOR, Arkansas
THOMAS R. CARPER, Delaware
CLAIRE MCCASKILL, Missouri
AMY KLOBUCHAR, Minnesota

TED STEVENS, Alaska, *Vice Chairman*
JOHN MCCAIN, Arizona
KAY BAILEY HUTCHISON, Texas
OLYMPIA J. SNOWE, Maine
GORDON H. SMITH, Oregon
JOHN ENSIGN, Nevada
JOHN E. SUNUNU, New Hampshire
JIM DEMINT, South Carolina
DAVID VITTER, Louisiana
JOHN THUNE, South Dakota
ROGER F. WICKER, Mississippi

MARGARET L. CUMMISKY, *Democratic Staff Director and Chief Counsel*
LILA HARPER HELMS, *Democratic Deputy Staff Director and Policy Director*
CHRISTINE D. KURTH, *Republican Staff Director and General Counsel*
PAUL NAGLE, *Republican Chief Counsel*

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM

BYRON L. DORGAN, North Dakota, *Chairman*
JOHN D. ROCKEFELLER IV, West Virginia
JOHN F. KERRY, Massachusetts
BARBARA BOXER, California
MARIA CANTWELL, Washington
MARK PRYOR, Arkansas
CLAIRE MCCASKILL, Missouri

JIM DEMINT, South Carolina, *Ranking*
JOHN MCCAIN, Arizona
OLYMPIA J. SNOWE, Maine
GORDON H. SMITH, Oregon
JOHN ENSIGN, Nevada
JOHN E. SUNUNU, New Hampshire

CONTENTS

IMPROVING CONSUMER PROTECTIONS IN SUBPRIME LENDING

TUESDAY, APRIL 29, 2008

U.S. SENATE,
SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:33 a.m. in room SR–253, Russell Senate Office Building, Hon. Byron L. Dorgan, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. I call the hearing to order. This is the Subcommittee on Interstate Commerce, Trade, and Tourism of the Senate Committee on Commerce, Science, and Transportation.

The subject of the hearing is improving consumer protections in subprime home lending.

Some weeks ago, in a rather stunning move, the Federal Reserve Board offered $30 billion of guarantees so that J.P. Morgan could take over Bear Stearns, which was a very large investment bank in this country and one that almost certainly would have been headed for bankruptcy in a very short period of time had the Fed not taken action to allow the purchase of Bear Stearns by J.P. Morgan.

The circumstances that led to all of this were subprime lending and the securitization of subprime mortgages. What has happened in our country in recent years is an unbelievable amount of speculation and financial engineering.

That financial engineering meant that firms would sell mortgages—some good mortgages, some not so good. They would package up the subprime mortgages with the good mortgages, just like they used to pack sawdust into sausages for filler. And then they'd slice them and dice them, and then they'd sell them two or three times after they were securitized, and nobody who ended up with them knew exactly what they had, except they were fairly high-yield because most of these subprime mortgages ended up with prepayment penalties. When the interest rates were reset, the borrower was going to pay very high interest rates.

Now, that's just a fact of what has happened. Most of us would have known this was going on because when we brush our teeth or shave in the morning while getting ready for work, if there's a television on, we've all seen the advertisements that started all of this: “You have bad credit? You’ve been bankrupt? You can’t get a loan? Come to us, we want to give you a loan.” We’ve all seen that and all wondered, “How does this add up?”

Well, the fact is, it didn’t add up, it doesn’t add up. And it has led not only to the collapse of Bear Stearns, a $30 billion guarantee by the Federal Reserve Board for some sour paper that exists. I believe, a $200 billion line of credit for direct lending to investment banks, the first time since the Great Depression—the list goes on. But also you can track a substantial portion of this back to an unbelievable amount of speculation and greed.

Now, we’re going to talk today about how all of this subprime lending happened, who was minding the store, who wasn’t minding the store, and what should we do going forward.

But first, I want to play a couple of videos, and I don’t know if everybody can see the videos. These are advertisements for mortgages.

[Video.]

Senator DORGAN. Those are all advertisements that ran in this country, enticing people to change their mortgage or, when they get a mortgage, to get a subprime mortgage from one of these companies. The only thing I agree with in that is, “No one can do it like Countrywide can,” and Countrywide couldn’t.

Let me just mention, the first advertisement was Linden Home Loans advertisement, and they did run small script at the bottom of the screen that you couldn’t see and, among other things, it says, “The minimum payments do not cover all of the interest due. The loan balances may increase or decrease based on the payment option chosen monthly. The maximum negative amortization is 115 percent of the original loan. The no points and no fee option requires a 3-year prepayment penalty. Rates are subject to change without notice.” That’s the thing they didn’t really want the person who watched the commercial to understand.

Predatory lending? Seems to me it is. Greed? Seems to me it is. We read that brokers that could put somebody in a $1 million subprime loan would get a $30,000 payment up front, as a fee—there was so much greed here, that it’s unbelievable to me.

By the way, I asked the presidents of all of the companies of which I just showed the commercials if they would join us this morning. They have decided they didn’t want to join us at this hearing.

But, I want to make this point. Let me show some, if I can, some charts of things I took off the Internet, just a couple of weeks ago, to show you that nothing has changed very much. I actually made charts of what I found on the Internet. This is a company that was advertising on the Internet 3 weeks ago—twenty-five hundredths of 1 percent and a fixed loan. Does anybody believe that? You get a fixed loan for one-fourth of 1 percent? The lowest fixed rate loan in America—well, I’d think so.

[Laughter.]

Senator DORGAN. One-quarter of 1 percent. Yes, I'd think that'd be the lowest. I don't think it's true, but I think that'd probably be the lowest advertised. "Borrow $200,000 for the payment of $41.66 a month." All right.

This I found on the Internet: "30-year fixed rate, from two and three-quarters percent." Does anybody believe you can find a 30-year fixed rate for two and three-quarters? I don't think so. Predatory lending? Well, that's Florida Mortgage corporation showing at least deceptive advertising, I would think. Next chart?

FLORIDA MORTGAGE CORPORATION
Financing properties all across Florida

APPLICATION	MORTGAGE PROGRAMS	TESTIMONIALS	ABOUT FMC	GUEST BOOK
FOR-SALE-BY-OWNER	CALCULATOR	GLOSSARY	MAP OF FMC	FLORIDA REALTORS
BI-WEEKLY	SUBSCRIBE	COMMERCIAL	EMAIL	HOME

2420 Enterprise Rd.
Suite #105
Clearwater, FL 33763
727-791-8800
Toll Free 888-825-6300

Monday - April 07, 2008

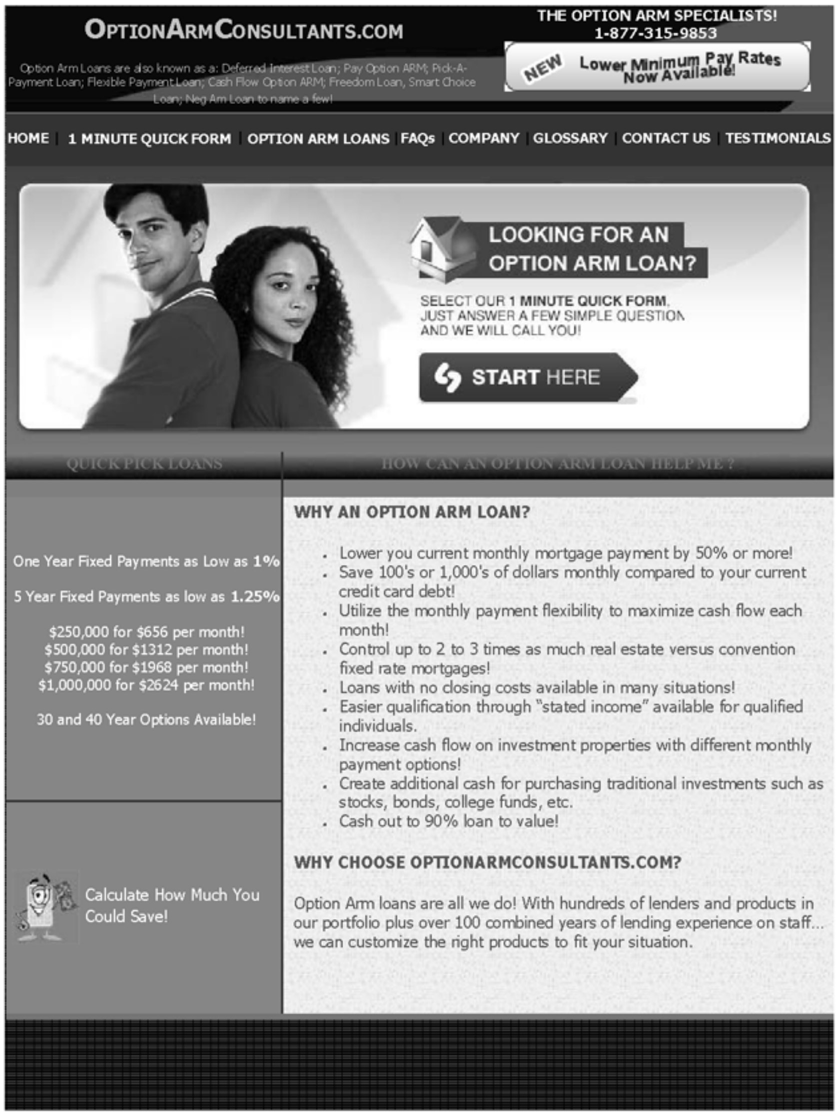
30 YEAR FIXED

Each month, you will receive a loan statement that lets you choose the payment amount that best suits your current financial needs. Pay the minimum amount to free up funds for other uses, or make larger payments for faster equity build-up. The lifetime fixed rate will never increase. This is *NOT* an adjustable interest rate.

Having up to four payment options allows you to manage your cash flow and overall financial picture on a monthly basis. After considering your monthly financial objectives, choose the available option that best suits your needs.

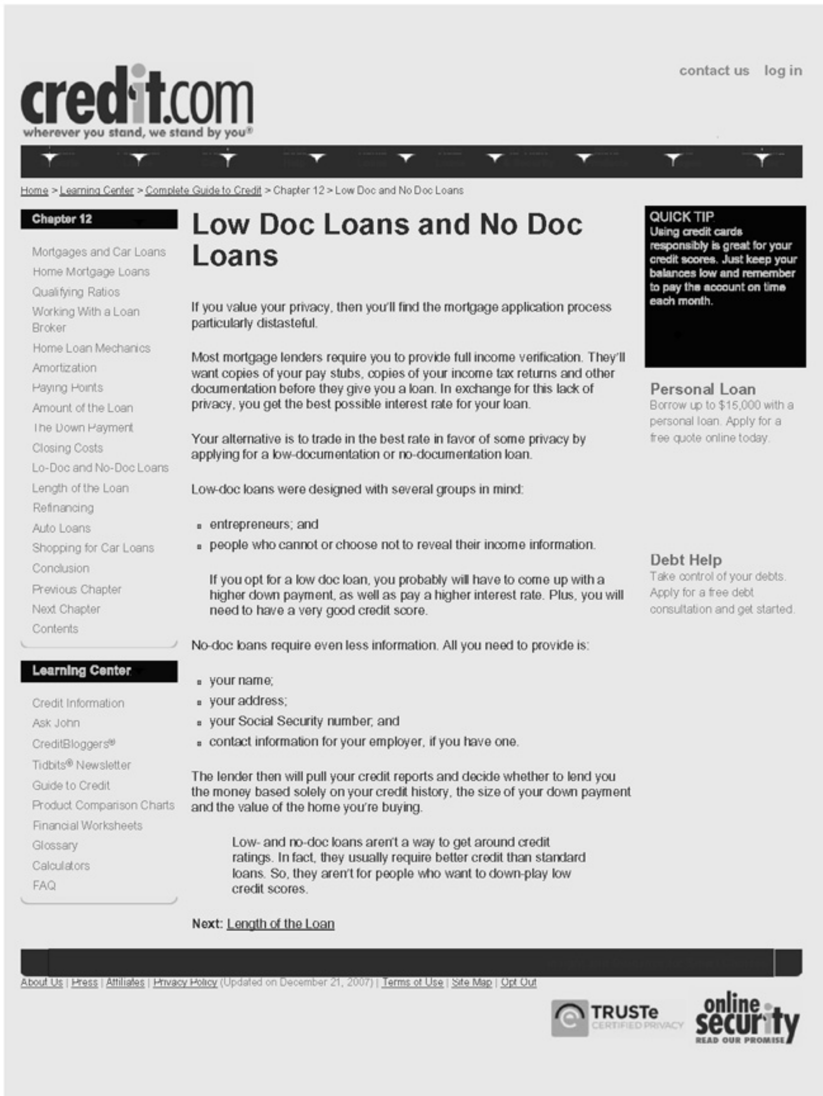
- **30 YEAR FIXED RATE - *FROM 2.75 %***
- Primary ⊠ Second Home ⊠ Investment Property
- Purchase ⊠ Refinance ⊠ Cash-Out Refinance
- Stated Income Available (NO Income Verification - NO IRS 4506)
- Loan Amounts: $60,000 to $3,000,000
- Four Payment Choices
- 1-4 Unit Residential Property
- Up To 90% Financing (With Lender Paid PMI)
- Portfolio Underwriting (NOT Credit Score Driven)
- From 2.45% For Investment Property (Non-Owner Occupied)
- NOT An Adjustable/Variable Rate - Fixed Rate Only
- Foreign National
- Corporation, LLC

Senator DORGAN. Five year, fixed payments, one and a quarter percent. That's being advertised on the Internet now, at least it was 2 weeks ago and suggests that you really ought to be speculating in real estate: "Control up to two to three times more real estate by using our rates."



Senator DORGAN. Finally, First Premier Mortgage—I don't know who they are or where they're from—but they said, "Perfect credit not required." Want to borrow from us? You don't need perfect credit. In fact, "We give you loans with no income verification."

Senator DORGAN. Well, we know, most of us know the terms, “no doc.” If you decide you don’t want to document your income in order to get a home mortgage, that’s kind of a good thing because then you pay a little higher interest rate, so you get your home mortgage without having to tell them all of your information about your financials, and the mortgage company actually makes a little more money—at least in the short-term, until it all collapses, of course.



credit.com
wherever you stand, we stand by you®

contact us log in

Home > Learning Center > Complete Guide to Credit > Chapter 12 > Low Doc and No Doc Loans

Chapter 12

- Mortgages and Car Loans
- Home Mortgage Loans
- Qualifying Ratios
- Working With a Loan Broker
- Home Loan Mechanics
- Amortization
- Paying Points
- Amount of the Loan
- The Down Payment
- Closing Costs
- Lo-Doc and No-Doc Loans
- Length of the Loan
- Refinancing
- Auto Loans
- Shopping for Car Loans
- Conclusion
- Previous Chapter
- Next Chapter
- Contents

Learning Center

- Credit Information
- Ask John
- CreditBloggers®
- Tidbits® Newsletter
- Guide to Credit
- Product Comparison Charts
- Financial Worksheets
- Glossary
- Calculators
- FAQ

Low Doc Loans and No Doc Loans

If you value your privacy, then you'll find the mortgage application process particularly distasteful.

Most mortgage lenders require you to provide full income verification. They'll want copies of your pay stubs, copies of your income tax returns and other documentation before they give you a loan. In exchange for this lack of privacy, you get the best possible interest rate for your loan.

Your alternative is to trade in the best rate in favor of some privacy by applying for a low-documentation or no-documentation loan.

Low-doc loans were designed with several groups in mind:

- entrepreneurs; and
- people who cannot or choose not to reveal their income information.

If you opt for a low doc loan, you probably will have to come up with a higher down payment, as well as pay a higher interest rate. Plus, you will need to have a very good credit score.

No-doc loans require even less information. All you need to provide is:

- your name;
- your address;
- your Social Security number; and
- contact information for your employer, if you have one.

The lender then will pull your credit reports and decide whether to lend you the money based solely on your credit history, the size of your down payment and the value of the home you're buying.

Low- and no-doc loans aren't a way to get around credit ratings. In fact, they usually require better credit than standard loans. So, they aren't for people who want to down-play low credit scores.

Next: Length of the Loan

QUICK TIP
Using credit cards responsibly is great for your credit scores. Just keep your balances low and remember to pay the account on time each month.

Personal Loan
Borrow up to $15,000 with a personal loan. Apply for a free quote online today.

Debt Help
Take control of your debts. Apply for a free debt consultation and get started.

About Us | Press | Affiliates | Privacy Policy (Updated on December 21, 2007) | Terms of Use | Site Map | Opt Out

TRUSTe CERTIFIED PRIVACY
online security READ OUR PROMISE

Senator DORGAN. And those are things that you can now go to the Internet and find, if you're curious about who's advertising in a deceptive way and who's trying to lure consumers.

Now, there's been this discussion about whether consumers are the victims? Or, are consumers also greedy? Wanting to get a quarter of 1 percent home loan—would they know better? The answer is, yes. They should know better. But let me make this point—the most complicated financial transaction in the life of most people will be negotiating a mortgage on their primary residence—it's the largest asset anyone will have, in most cases, and getting a home mortgage is very complicated.

I would like to know if anybody in this room—and I already know the answer—if anybody in this room has read through all of the papers that accompanied the mortgage you received on your home. And the answer is no, of course not. You could not possibly have done it. So, we rely on fair advertising, accurate advertising, and promotion of products that represents some basic honesty. And regrettably, that has not been the case.

I don't want to tarnish everybody. There are some good folks out there providing home loans today, and owning a home is the American Dream. It used to be a sleepy old industry, you went down to the corner in your town and you sat with the person at the savings and loan who'd been there for 20 years, and they told you exactly what was going on, and you got a home loan, a mortgage, and everybody was happy.

That sleepy industry turned into a Roman candle, recently, with a lot of powder, and a lot of flash. And now we see a lot of people making a lot of money, and the whole tent collapses because they've built a house of cards.

The last ad was Countrywide. Countrywide was the largest home loan lender in this country. And they were doing a lot of things—they were securitizing, they were doing everything. But, they had brokers out there that were selling products. Among other things, they were putting people into subprimes that would have qualified for other mortgages—a whole series of things.

And, by the way, Countrywide has now been bought by another company but the person that constructed Countrywide, and was engaged in this, made off with hundreds of millions of dollars. Hundreds of millions of dollars.

There's a massive amount of greed, here, and the reason I'm holding this hearing is to try to figure out, what we are we doing about this. First of all, who is responsible? And second, why is it still happening? And third, what are we going to do to stop it?

Greed is pretty hard to stop. Sometimes collapse stops it, but we've put now a safety net under institutions that we've been told are too big to fail but apparently not big enough to regulate. Something's wrong with that. If you're too big to fail, you're not too small to regulate. And if the American taxpayer is going to have to put a safety net under investment banks, and we're now going to lend money directly to investment banks through the Fed, then there needs to be an understanding that there should be some thoughtful regulation.

I know regulation, for years, in this town has been a four-letter word, but it's not a four-letter word when you look at predatory lending. The greed that's happened in all of these areas—and this goes from the brokers, in some cases, to the mortgage lenders, to the hedge funds—right up and down the line. Unbelievable profits—staggering profits. Then guess what? Then the Federal Government, the poor old taxpayer, and also some folks that received bad mortgages, end up holding the bag.

So, obviously that was my short rant at the start of this because there is something dreadfully wrong here. At this point nobody is prepared to fix it. And we need to do that.

We have a hearing today, Ms. Lydia Parnes is with us. She is the Director of the Bureau of Consumer Protection at the Federal

Trade Commission. We will have a second panel of the Attorney General of the State of Connecticut, Richard Blumenthal—we appreciate his attendance—Kathleen Keest, Senior Policy Counselor for the Center for Responsible Lending; Ira Rheingold, the Executive Director of the National Association of Consumer Advocates; and Bill Himpler, Executive Vice President of Federal Affairs of the American Financial Services Association.

I want to make one final point because I've talked a lot about greed and deception, and so on. I want to emphasize this point: there are good, honest, decent people in the industry we're talking about, who try to do a good job. And their reputation, too, regrettably, is tarnished by those that are trying to make a fast buck and those that are greedy.

But, this morning there is someone buying a house, sitting across the desk in a financial institution that they can trust, working with a mortgage counselor they can trust, and they're being able to purchase their American Dream. I don't want this hearing, and I don't want other discussions to tarnish the goodwill and the honesty of a lot of people who work hard.

But I want to point out that the dramatic increase in subprime loans by companies that have embedded in those loans unbelievable terms, penalties, and so on, in order to load up a piece of sausage that they would slice up and securitize with high rates—gave everybody the opportunity to behave like hogs in the corn crib. And frankly, this has to stop.

So, Ms. Lydia Parnes, thank you for being with us. I want to challenge you a little, as well. I like the Federal Trade Commission, but I think it's been absent on some of these issues, so I'd like to hear your statement, then I want to ask you some questions.

You may proceed.

STATEMENT OF LYDIA B. PARNES, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

Ms. PARNES. Well, thank you, Chairman. I'm pleased to be here today to discuss the FTC's actions to protect consumers in the subprime mortgage marketplace.

As we are all well-aware, the recent crisis of subprime mortgage delinquencies and foreclosures is taking a toll on American consumers and their community.

As the nation's consumer protection agency, we understand at the Commission that we do have a critical role to play in the subprime mortgage marketplace.

And Chairman Dorgan, the Commission appreciates your efforts, and the efforts of this Subcommittee to address consumer protection problems in the subprime mortgage area.

First and foremost, the Commission is a law enforcement agency with wide-ranging responsibilities, including over consumer financial issues. Mortgage lending has long been a Commission priority. In the past decade, the agency has brought 22 actions focused on the mortgage lending industry, with particular attention to the subprime market, alleging that lenders and servicers have engaged in unfair and deceptive advertising and mortgage servicing practices. Through these cases, the FTC has returned more than $320 million to consumers.

Today, the Commission is announcing its most recent action to protect consumers from mortgage foreclosure rescue scams. The FTC sued Foreclosure Solutions, alleging that it targets consumers facing foreclosure, charged these consumers an up-front fee of about $1,000, and represented that they would stop the foreclosure.

In fact, according to the FTC's complaint, the defendants engaged in minimal efforts on behalf of consumers, and consumers either lost their homes, or avoided foreclosure by exercising the same options that were available to them, anyway.

The Commission has filed 3 cases this year against other defendants, allegedly engaged in mortgage foreclosure rescue fraud, and we have more investigations underway. We also continue to conduct outreach and share enforcement resources with state and local authorities through 7 regional task forces in cities with particularly high foreclosure rates.

For consumers, deceptive mortgage advertisements can lead to an ultimately devastating experience, and so we are aggressively examining advertisements that appear in a variety of media. We're investigating the ads of about a dozen companies. Last year, we reviewed hundreds of mortgage advertisements and sent warning letters, as you know, to 200 mortgage lenders, because their ads did not appear to comply to the laws we enforce.

We're going back to those advertisers, and then if they're still non-compliant, we will follow up with law enforcement.

Further FTC law enforcement to protect borrowers will include enforcing new Federal Reserve Board mortgage lending rules. The Fed has proposed rules that prohibit certain unfair, deceptive, or abusive acts and practices in mortgage advertising, origination, appraisal and servicing. It has received public comment on these rules, and has announced that it will issue its new rules before the end of 2008.

We filed comments largely supportive of the proposed Fed rules. The Commission has the authority to enforce the final rules against the non-bank entities under its jurisdiction, and we commit to doing so.

As noted in the Commission's written testimony, the FTC's enforcement efforts would be more effective if it could obtain civil penalties for violations of these rules.

In conjunction with our law enforcement, we engage in extensive educational activities to empower consumers to better protect themselves. The Commission recently developed new educational materials in English and Spanish, to provide information to consumers about deceptive mortgage ads, mortgage foreclosure rescue scams, buying a home, and steps borrowers can take to avoid foreclosure.

We also understand that mortgage disclosures are critical to helping consumers making better informed purchasing decisions. Next month, the FTC's Bureau of Economics will host a conference to discuss strategies for ensuring that mortgage disclosures provide the greatest benefit to consumers. And the FTC's conference is, we believe, timely with the Department of Housing and Urban Development considering substantial revisions to its mortgage disclosure rules, under the Real Estate Settlement Procedures Act.

We hope that the discussions at the conference will promote comprehensive mortgage disclosure reform, so that consumers receive key information in a manner that is as clear and understandable as possible.

Chairman thank you for your attention, and I'd be happy to answer any of your questions.

[The prepared statement of Ms. Parnes follows:]

PREPARED STATEMENT OF LYDIA B. PARNES, DIRECTOR, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

I. Introduction

Chairman Dorgan, Ranking Member DeMint, and Members of the Committee, I am Lydia B. Parnes, Director of the Bureau of Consumer Protection at the Federal Trade Commission ("FTC" or "Commission").[1] I appreciate the opportunity to appear before you today to discuss the Commission's wide range of activities to protect consumers in the subprime mortgage market. The Commission is concerned about the rise in delinquencies and foreclosures in the subprime market, and the impact on communities, and is committed to using all of its tools to protect consumers in this market.

During today's testimony, the FTC would like to emphasize the following points:

- The Commission has been at the forefront of the fight against deceptive subprime lending and servicing practices since 1998, when it filed its case against Capital City Mortgage, which allegedly took advantage of African American consumers here in Washington, D.C.
- In the past decade, the FTC has brought 22 actions focused on the mortgage lending industry, with particular attention to entities in the subprime market, alleging that mortgage lenders and servicers engaged in unfair or deceptive acts and practices. Through these cases, the FTC has returned more than $320 million to consumers. Many of these cases have challenged deceptive advertising and marketing practices.
- The Commission is currently investigating more than a dozen mortgage companies as part of a mortgage advertising law enforcement sweep. In addition to these investigations, the Commission sent more than 200 warning letters last year to mortgage brokers and lenders, as well as the media outlets that carry their home mortgage advertisements. FTC staff recently reviewed the current advertising of those who received warning letters and will follow up with law enforcement where appropriate.
- With the recent rapid increase in mortgage delinquencies and foreclosures, the FTC also has intensified its focus on protecting consumers from mortgage foreclosure rescue scams. The Commission has filed law enforcement actions against defendants allegedly engaged in mortgage foreclosure fraud, and has additional nonpublic matters under investigation.
- This month, Commission staff filed a public comment in response to the Federal Reserve Board's proposed rules to restrict certain mortgage practices. The comment supports the Board's goals of protecting consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. If finalized, the FTC will have the authority to enforce these rules against nonbank entities under its jurisdiction. The FTC's enforcement efforts would be more effective if it could obtain civil penalties for violations of these rules.
- To empower consumers to better protect themselves from potentially harmful conduct, the FTC also engages in extensive consumer education related to mortgage lending. The FTC has recently developed new educational materials in English and Spanish to provide information about deceptive mortgage advertisements, mortgage foreclosure rescue scams, buying a home, and the steps borrowers can take to avoid foreclosure.
- The Commission also engages in research and policy development to better understand and protect consumers in the mortgage marketplace. Next month, FTC staff economists will host a conference to assess the role of consumer information in the current mortgage crisis and discuss strategies for ensuring that

[1] The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions are my own, however, and do not necessarily reflect the views of the Commission or any individual Commissioner.

mortgage disclosures will be designed to provide the greatest benefit to consumers.

This testimony will discuss: (1) the Commission's authority and mission related to subprime lending; and (2) the FTC's efforts to protect mortgage borrowers, particularly in the subprime market. As detailed below, the agency's priorities include deceptive mortgage advertising, deceptive or unfair servicing practices, discrimination in lending, and foreclosure rescue scams.

II. The FTC's Role in Subprime Lending

As the primary Federal agency that enforces consumer credit laws with respect to entities other than banks, thrifts, and Federal credit unions, the Commission has wide-ranging responsibility regarding consumer financial issues in the mortgage market, including those involving mortgage lenders, brokers, and servicers. The FTC enforces a number of Federal laws governing mortgage lending, including the Truth in Lending Act ("TILA"),[2] the Home Ownership and Equity Protection Act ("HOEPA"),[3] and the Equal Credit Opportunity Act ("ECOA").[4] The Commission also enforces Section 5 of the Federal Trade Commission Act ("FTC Act"), which more generally prohibits unfair or deceptive acts or practices in the marketplace.[5] In addition, the Commission enforces a number of other consumer protection statutes that govern financial service providers, including the Consumer Leasing Act,[6] the Fair Debt Collection Practices Act,[7] the Fair Credit Reporting Act,[8] the Credit Repair Organizations Act,[9] and the privacy provisions of the Gramm-Leach-Bliley Act.[10]

The Commission's legal authority does not extend to all entities that provide financial services to consumers. The FTC Act and the credit statutes that the FTC enforces specifically exempt banks, thrifts, and Federal credit unions, among other types of entities, from the Commission's jurisdiction.[11] The FTC, however, has jurisdiction over nonbank financial companies, including nonbank mortgage companies, mortgage brokers, and finance companies. The agency also coordinates regularly on financial practices matters with Federal banking agencies, the Department of Justice ("DOJ") and the Department of Housing and Urban Development ("HUD"). In addition, the FTC cooperates with state attorneys general and state banking departments to protect consumers in the mortgage lending arena.

The Commission employs a multi-faceted approach to protect consumers in the subprime market. The Commission brings enforcement actions against entities that violate the law, educates consumers and businesses as to their rights and responsibilities under the law, and engages in research to adapt its policies to protect consumers more effectively. The testimony below discusses how the FTC is using this approach to protect consumers in the subprime mortgage marketplace.

III. Protecting Subprime Mortgage Borrowers

The Commission is committed to using all means at its disposal to protect mortgage borrowers from those who would prey on their financial turmoil, and to provide information to help these consumers confront the challenges they face.

---

[2] 15 U.S.C. §§ 1601–1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions).

[3] 15 U.S.C. § 1639 (providing additional protections for consumers who enter into certain high-cost refinance mortgage loans). HOEPA is a part of TILA.

[4] 15 U.S.C. §§ 1691–1691f (prohibiting creditor practices that discriminate on the basis of race, religion, national origin, sex, marital status, age, receipt of public assistance, and the exercise of certain legal rights).

[5] 15 U.S.C. § 45(a).

[6] 15 U.S.C. §§ 1667–1667f (requiring disclosures, limiting balloon payments, and regulating advertising in connection with consumer lease transactions).

[7] 15 U.S.C. §§ 1692–1692p (prohibiting abusive, deceptive, and unfair debt collection practices by third-party debt collectors).

[8] 15 U.S.C. §§ 1681–1681x (imposing standards for consumer reporting agencies and information furnishers in connection with the credit reporting system and placing restrictions on the use of credit reporting information).

[9] 15 U.S.C. §§ 1679–1679j (prohibiting untrue or misleading representations, requiring certain affirmative disclosures, and imposing other restrictions in the offering and sale of "credit repair" services).

[10] 15 U.S.C. §§ 6801–6809 (imposing requirements on financial institutions with respect to annual privacy notices, procedures for providing customers an opt-out from having certain information shared with nonaffiliated third parties, and safeguarding customers' personally identifiable information).

[11] *See, e.g.,* 15 U.S.C. § 45(a)(2).

A. Law Enforcement

The Commission's law enforcement actions have targeted deception and other illegal practices in the mortgage market, with a particular focus on the subprime market. In recent years, the agency has brought 22 actions against companies and principals in the mortgage lending industry, including both large and small companies located throughout the country.[12] Several of these cases have resulted in large monetary judgments, collectively returning more than $320 million to consumers. These enforcement actions have targeted deceptive or unfair practices in all stages of mortgage lending—from advertising and marketing through loan servicing—by mortgage lenders, brokers, and loan servicers.

In most of its mortgage lending cases, the Commission has challenged deception in the advertising or marketing of subprime loans. For example, the FTC's complaint against a large subprime mortgage lender, Associates First Capital Corp. and Associates Corporation of North America (the "Associates"), alleged that the defendants marketed subprime mortgage loans through false and misleading statements about loan costs.[13] Specifically, the complaint alleged that the Associates represented that consumers would save money when consolidating their existing debts, but these "savings claims" did not take into account the loan fees and closing costs the company typically added to consumers' loan amounts. Further, the claims did not reveal that, for certain Associates loans, consumers would pay only interest and still would owe the entire principal amount in a "balloon" payment at the end of the loan term. The complaint also challenged as deceptive the Associates' practice of including single-premium credit insurance in loans, without disclosing its inclusion to consumers. The defendants paid a record-setting $215 million in consumer redress to settle the allegations in the FTC complaint.[14]

Mortgage brokers also have been the subject of substantial FTC law enforcement activity in recent years. The FTC has brought enforcement actions against brokers for allegedly deceiving consumers about key loan terms, such as the existence of a prepayment penalty[15] or a large balloon payment due at the end of the loan.[16] In some of these cases, the Commission also has charged brokers with falsely promising consumers low fixed payments and rates on their mortgage loans.[17] For example, in June 2004, the Commission sued Chase Financial Funding ("CFF"), a California mortgage broker, and its principals, in connection with sending unsolicited e-mail and direct mail promising a "3.5 percent fixed payment loan."[18] The FTC alleged that CFF did not offer any such loan and that the loan CFF falsely advertised was actually a "payment option" adjustable rate mortgage in which interest accrued at a rate higher than advertised, the principal balance would increase if consumers made payments at the advertised rates, and the payments were not "fixed."

In 2006, the Commission filed suit against a mortgage broker for allegedly misrepresenting numerous key loan terms to Hispanic consumers who sought to refinance their homes.[19] As alleged in the Commission's complaint, the defendant conducted business with his clients almost entirely in Spanish but then provided at closing loan documents in English containing less favorable terms. As a result of

---

[12] *FTC* v. *Safe Harbour Found. of Fl., Inc.,* No. 08–1185 (N.D. Ill. 2008); *FTC* v. *Mortgages Para Hispanos.com Corp.,* No. 06–00019 (E.D. Tex. 2006); *FTC* v. *Ranney,* No. 04–1065 (D. Colo. 2004); *FTC* v. *Chase Fin. Funding,* No. 04–549 (C.D. Cal. 2004); *United States* v. *Fairbanks Capital Corp.,* No. 03–12219 (D. Mass. 2003); *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2002); *United States* v. *Mercantile Mortgage Co.,* No. 02–5079 (N.D. Ill. 2002); *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. 2001); *FTC* v. *First Alliance Mortgage Co.,* No. 00–964 (C.D. Cal. 2000); *United States* v. *Action Loan Co.,* No. 00–511 (W.D. Ky. 2000); *FTC* v. *NuWest, Inc.,* No. 00–1197 (W.D. Wash. 2000); *United States* v. *Delta Funding Corp.,* No. 00–1872 (E.D.N.Y. 2000); *FTC* v. *Barry Cooper Prop.,* No. 99–07782 (C.D. Cal. 1999); *FTC* v. *Capitol Mortgage Corp.,* No. 99–580 (D. Utah 1999); *FTC* v. *CLS Fin. Serv., Inc.,* No. 99–1215 (W.D. Wash. 1999); *FTC* v. *Granite Mortgage, LLC,* No. 99–289 (E.D. Ky. 1999); *FTC* v. *Interstate Res. Corp.,* No. 99–5988 (S.D.N.Y. 1999); *FTC* v. *LAP Fin. Serv.,* Inc., No. 99–496 (W.D. Ky. 1999); *FTC* v. *Wasatch Credit Corp.,* No. 99–579 (D. Utah 1999); *In re First Plus Fin. Group, Inc.,* FTC Docket No. C–3984 (2000); *In re Fleet Fin., Inc.,* FTC Docket No. C–3899 (1999); *FTC* v. *Capital City Mortgage Corp.,* No. 98–00237 (D.D.C. 1998).

[13] *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. 2001).

[14] *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. Sept. 23, 2002) (Order Preliminarily Approving Stipulated Final Judgment and Order). Defendants paid an additional $25 million to settle a concurrent class action.

[15] *FTC* v. *Chase Fin. Funding,* No. 04–549 (C.D. Cal. 2004); *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2002).

[16] *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2002).

[17] *FTC* v. *Chase Fin. Funding,* No. 04–549 (C.D. Cal. 2004); *FTC* v. *Ranney,* No. 04–1065 (D. Colo. 2004); *FTC* v. *Diamond,* No. 02–5078 (N.D. Ill. 2002).

[18] *FTC* v. *Chase Fin. Funding,* No. 04–549 (C.D. Cal. 2004).

[19] *FTC* v. *Mortgages Para Hispanos. Com Corp.,* No. 06–00019 (E.D. Tex. 2006).

the FTC's case, the lender has been permanently enjoined from misrepresenting loan terms. In addition, the court entered a suspended judgment of $240,000 against the broker, and the broker paid $10,000 in consumer redress based on a documented inability to pay the full judgment amount.[20]

Currently, the Commission is investigating more than a dozen mortgage companies as part of a mortgage advertising law enforcement sweep. In addition, in September 2007, the Commission sent warning letters to more than 200 mortgage brokers and lenders, and media outlets that carry their advertisements for home mortgages, to advise them that certain of their mortgage ads may be deceptive in violation of Section 5 of the FTC Act or may violate the TILA.[21] The FTC identified the ads, including some in Spanish, in June 2007 during its nationwide review of ads featuring claims for very low interest rates or monthly payment amounts without adequate disclosure of other important loan terms. The Commission staff recently reviewed the current advertising of those who received warning letters and will follow up with law enforcement where appropriate.

In addition to law enforcement related to mortgage advertising, the FTC plays an important role in preventing unlawful mortgage discrimination.[22] Since the ECOA was enacted, the Commission has brought more than three dozen cases against large subprime lenders, major non-mortgage creditors, and smaller finance companies alleging ECOA violations. About two dozen of these cases have alleged substantive discrimination on the basis of race, marital status, sex, age, and the receipt of public assistance.

The FTC closely coordinates its fair lending investigations with those of other Federal law enforcement agencies.[23] A major component of the Commission's investigations is a statistical analysis of the data that companies within the FTC's jurisdiction have produced pursuant to the Home Mortgage Disclosure Act ("HMDA").[24] At this time, the Commission is conducting several non-public investigations of mortgage originators for possible violations of fair lending laws.

The FTC also has challenged deceptive and unfair practices in the servicing of mortgage loans. For example, in November 2003, the Commission, along with the HUD, announced a settlement with Fairbanks Capital Corp. and its parent company. The Commission alleged that Fairbanks (now called Select Portfolio Servicing, Inc.) failed to post consumers' payments upon receipt, charged unauthorized fees, used dishonest or abusive tactics to collect debts, and reported to credit bureaus consumer payment information that it knew to be inaccurate.[25] The settlement agreement included a $40 million redress fund for consumers as well as strong injunctive provisions and specific safeguards to prevent the company from foreclosing on consumers without cause.[26] Furthermore, last year, based on a compliance review of the company, the Commission negotiated modifications of the 2003 consent order. The modified consent order provides substantial benefits to consumers beyond those in the original order, including additional refunds of fees paid in certain circumstances.[27]

The Commission continues to investigate mortgage servicing practices for compliance with the law. Last month, The Bear Stearns Companies, Inc. ("Bear Stearns")

---

[20] *FTC* v. *Mortgages Para Hispanos. Com Corp.,* No. 06–00019 (E.D. Tex. Sept. 25, 2006) (Stipulated Final Judgment and Order of Permanent Injunction).

[21] *See* Press Release, FTC, FTC Warns Mortgage Advertisers and Media That Ads May Be Deceptive (Sept. 11, 2007), available at *www.ftc.gov/opa/2007/09/mortsurf.shtm.*

[22] The Commission's July 25, 2007 testimony before the Subcommittee on Oversight and Investigations of the House Committee on Financial Services detailed the Commission's fair lending program. The testimony is available at *www.ftc.gov/os/testimony/P064806hdma.pdf*.

[23] For more than a decade, the FTC has been a member of the Interagency Task Force on Fair Lending, a joint undertaking with the DOJ, the HUD, and the Federal banking regulatory agencies. Task Force members meet often to share information on lending discrimination, predatory lending enforcement, and policy issues.

[24] 12 U.S.C. § 2801. HMDA requires certain mortgage lenders located in metropolitan areas to collect and report to the government data about their housing-related loans and applications for such loans. The data include pricing data for higher-priced loans made in 2004 or later. Of the 8,886 institutions that reported HMDA data in 2006, 2,004 institutions are nondepository institutions subject to FTC jurisdiction. Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner, *The 2006 HMDA Data,* 93 FEDERAL RESERVE BULLETIN (Dec. 2007) at A73, available at *www.Federalreserve.gov/pubs/bulletin/2007/pdf/hmda06final.pdf*. The remaining 6,882 institutions reporting data are depository institutions subject to Federal banking agency jurisdiction.

[25] *United States* v. *Fairbanks Capital Corp.,* No. 03–12219 (D. Mass. 2003).

[26] *United States* v. *Fairbanks Capital Corp.,* No. 03–12219 (D. Mass. Nov. 21, 2003) (Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital Corp. and Fairbanks Capital Holding Corp.).

[27] *United States* v. *Fairbanks Capital Corp.,* No. 03–12219 (D. Mass. Sept. 4, 2007) (Modified Stipulated Final Judgment and Order).

disclosed that FTC staff has notified its mortgage servicing subsidiary, EMC Mortgage Corporation ("EMC"), that the staff believes EMC and its parent Bear Stearns have violated a number of Federal consumer protection statutes in connection with its servicing activities. Bear Stearns further disclosed that FTC staff offered an opportunity to resolve the matter through consent negotiations before seeking approval from the Commission to proceed with the filing of a complaint. According to the disclosure, EMC expects to engage in such discussions with Commission staff.[28] The FTC cannot comment further on this ongoing law enforcement investigation.

Finally, with the rapid increase in mortgage delinquencies and foreclosures, the FTC has intensified its efforts to protect consumers from mortgage foreclosure rescue scams.[29] There are many varieties of mortgage foreclosure rescue fraud but, in each case, the perpetrator makes misleading promises that a consumer's home will be saved from the pending foreclosure permanently.[30] Many consumers, however, ultimately lose their homes and lose the money they paid to scammers.

In February of this year, the Commission announced three cases targeting mortgage foreclosure rescue scams. These scams, as well as additional conduct currently under investigation, share at least two common characteristics. First, the fraudulent schemes target consumers who face imminent foreclosure and who thus have limited time and resources to save their homes. Second, these schemes falsely promise that they can save the consumers' homes from foreclosure.

In two of these cases, the Commission alleges that the defendants promise to stop foreclosure in exchange for a consumer's up-front payment of $500 to $1,200. After a consumer makes the payment, the defendants do little or nothing to stop the foreclosure. This fraud deprives consumers not only of much-needed funds but also of the opportunity to explore realistic options to avoid foreclosure.[31] In the third case, the Commission alleges that the defendants entice consumers into a second mortgage or home equity line of credit on very unfavorable terms without fully disclosing the costs, risks, and consequences of doing so.[32]

As described above, the Commission has a vigorous law enforcement program to protect consumers in connection with many aspects of their mortgage loans. The FTC continues to explore ways to enhance the effectiveness of its law enforcement activities related to subprime lending. For example, through the Interagency Pilot Project to Review Subprime Lender Conduct, the FTC, the Federal Reserve Board ("FRB"), the Office of Thrift Supervision ("OTS"), and two associations of state regulators have combined forces to undertake an innovative law enforcement project. The agencies are jointly conducting consumer protection compliance reviews and investigations of certain nonbank subsidiaries of bank holding companies with significant subprime mortgage operations.[33]

B. Consumer Education

Although law enforcement is the primary means that the Commission uses to combat illegal mortgage lending acts and practices, consumers are, of course, better off if they are not injured in the first place. To empower consumers to better protect themselves from potentially harmful conduct, the FTC engages in extensive consumer education related to mortgage lending.

In 2007, the Commission released several new mortgage-related consumer brochures, including brochures on deceptive mortgage advertisements, buying a home, how to manage a mortgage if the mortgage lender goes out of business or files for bankruptcy, and high-rate, high-fee mortgages.[34] To help consumers facing possible

[28] Form 10–K, Bear Stearns Mortgage Funding Trust 2007–AR4 (CIK No. 1393708), at Item 1117 of Reg AB, Legal Proceedings (filed Mar. 31, 2008), available at *www.sec.gov/Archives/edgar/data/1393708/000105640408001164/0001056404-08-001164.txt.*

[29] In testimony on February 13, 2008 before the Senate Special Committee on Aging on foreclosure rescue fraud, the Commission set forth a more complete description of the FTC's efforts to address such fraud. The FTC's testimony is available at *ftc.gov/os/testimony/P064814foreclosure.pdf.*

[30] *See* Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem*, CLEARINGHOUSE REV. J. OF POVERTY LAW AND POL'Y, Mar.-Apr. 2006 at 607, 608.

[31] *FTC* v. *Mortgage Foreclosure Solutions, Inc.,* Case No. 8:08–cv–388–T–23EAJ (M.D. Fla., filed Feb. 26, 2008); *FTC* v. *National Hometeam Solutions, Inc.,* Case No. 4:08–cv–067 (E.D. Tex., filed Feb. 26, 2008).

[32] *FTC* v. *Safe Harbour Foundation,* No. 08 C 1185 (N.D. Ill., filed Feb. 25, 2008).

[33] *See* Press Release, FTC, Federal and State Agencies Announce Pilot Project to Improve Supervision of Subprime Mortgage Lenders (July 17, 2007), available at *www.ftc.gov/opa/2007/07/subprime.shtm.*

[34] The Commission's consumer education materials are available from the FTC's website, *www.ftc.gov*. The FTC publishes many of its materials in both English and Spanish. Educational

Continued

foreclosure, the Commission also released an alert offering guidance on steps borrowers can take to avoid foreclosure. In conjunction with its law enforcement actions alleging foreclosure rescue schemes, the Commission also developed a stepped-up consumer outreach initiative on foreclosure rescue fraud. Among other things, the FTC submitted a series of radio public service announcements, in English and Spanish, to stations in cities hardest hit by mortgage foreclosures and published classified advertisements in English- and Spanish-language community newspapers.[35] All of the Commission's consumer protection materials, including many released in Spanish as part of the Commission's Hispanic Outreach Program, are available to the public on the FTC's website or by calling the FTC's Consumer Response Center toll-free at 1–877–FTC–HELP.[36]

The Commission also regularly partners with other agencies to educate consumers. Partnering with other agencies has proven to be an effective technique because it taps the respective expertise and distribution channels of the agencies involved. The FTC has jointly published with the banking regulators, the DOJ, and HUD, brochures addressing key lending issues.[37] The FTC continues to participate in the governmental Financial Literacy and Education Commission, contributing its expertise to subcommittees that produced *MyMoney.gov* and *Taking Ownership of the Future: The National Strategy for Financial Literacy.*[38]

C. Research and Policy Development

The mortgage marketplace in the United States is dynamic. The Commission therefore engages in public workshops and other research efforts so that it may better understand particular consumer protection issues in the changing marketplace, and advocate for policies that promote protections for consumers, such as policies that foster informed mortgage borrowing.

For example, in June 2007, the FTC staff released an empirical study assessing the effectiveness of mortgage disclosure documents that mortgage originators are required to provide to consumers under the Real Estate Settlement Procedures Act ("RESPA") and TILA.[39] The study found that these disclosures were not very effective in helping consumers of subprime and prime mortgages understand the terms of mortgages and their implications. The study also demonstrated that consumers could benefit from changes in current disclosure requirements. Significantly, the study suggested that, in actual market transactions, subprime borrowers may face even greater difficulties understanding the terms of their mortgages than they did in the study and, therefore, these borrowers may benefit the most from improved disclosures.

Based in part on its mortgage disclosure study, the FTC staff in November 2007 submitted comments to the Federal banking agencies in response to their request for comments on proposed illustrations to disclose information to consumers about subprime mortgages.[40] The comments stated that consumers likely would benefit from one clear disclosure document that alerts them to the major costs and features of a mortgage. The comments also noted that such a document would significantly reduce the cost of obtaining accurate information about the value of different mortgage options, be noticeable and easy to read and understand, feature up-front summaries of key loan features, and make clear what a consumer is getting before sign-

---

materials on mortgage and real estate issues are directly accessible from the FTC's webpage, Credit and Loans: Mortgages/Real Estate, *www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm*. In Spanish, the materials are available from the FTC's webpage, Crédito y Préstamos: Hipotecas/Propiedades, *www.ftc.gov/bcp/menus/consumer/credit/mortgage_es.shtm*.

[35] The Commission also will send information to community libraries, unions, and other organizations warning consumers about foreclosure rescue scams.

[36] The Commission's Spanish-language publications are available from its webpages, Información de la FTC para Consumidores, available at *www.ftc.gov/bcp/consumer_es.shtm,* and OJO! Mantente alerta contra el fraude: Infórmate con la FTC, available at *www.ftc.gov/ojo*.

[37] *See, e.g., Looking for the Best Mortgage? Shop, Compare, and Negotiate,* available at *www.ftc.gov/bcp/edu/pubs/consumer/homes/rea09.shtm*.

[38] *See www.mymoney.gov.* In addition, each year, the FTC participates in Financial Literacy Month. Activities include presentations to students on the importance of responsible credit card use and safeguarding personal information, and exhibits at Financial Literacy Day on Capitol Hill, where agency representatives distribute free consumer education materials.

[39] JAMES M. LACKO & JANIS K. PAPPALARDO, FEDERAL TRADE COMM'N, BUREAU OF ECONOMICS STAFF REPORT, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007), available at *www.ftc.gov/os/2007/06/P025505mortgagedisclosurereport.pdf*.

[40] *See* FEDERAL TRADE COMM'N STAFF COMMENTS TO JENNIFER J. JOHNSON, SECRETARY, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (November 2007), available at *www.ftc.gov/be/v080000.pdf*.

ing legal documents. The comments further noted the importance of consumer research and expressed the FTC staff's readiness to participate with the FRB and HUD in a more comprehensive effort to improve mortgage disclosures.[41]

Next month, the FTC will host a conference to highlight and assess the role of consumer information in the current mortgage crisis from an economic perspective. Experts from several relevant specialties will gather to examine how consumer information—and regulation of such information—affects consumer choices, mortgage outcomes, and consumer welfare. For example, panelists will discuss the causes and effects of mortgage market product developments, the role of consumer information in the mortgage market and how it relates to the current mortgage crisis, and strategies for ensuring that mandatory information disclosures will provide the greatest benefit to consumers.

Finally, the Commission continues to coordinate and share its expertise with Federal banking agencies in connection with their proposals to protect consumers in the mortgage marketplace. This month, the FTC staff filed a public comment with the FRB in response to its proposed rule to restrict certain mortgage practices under the TILA and HOEPA.[42] In the comment, the FTC staff supported the FRB's goals of: (1) protecting consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices while preserving responsible lending and sustainable home ownership; (2) ensuring that advertisements for mortgage loans are accurate and not misleading; and (3) providing consumers with transaction-specific disclosures early enough to use while shopping. The comment concludes that the FRB's proposed restrictions on appraisal, servicing, and advertising practices, and the revised timing requirement for TILA disclosures, would be beneficial for consumers. The comment also notes that, while FRB's proposed restrictions on a new category of higher-cost loans appear to strike a reasonable balance, FTC staff encourages the FRB to continue to weigh their potential benefits and costs, including considering any empirical evidence submitted in response to its proposed rulemaking to confirm that this balance is reasonable. Finally, the comment assesses the Board's proposal regarding mortgage broker compensation disclosures and recommends an alternative approach.[43]

If the FRB's proposed rules are finalized, the Commission will have the authority to enforce those rules against nonbank entities under its jurisdiction. As with its current authority, the Commission intends to use that new authority to the fullest extent possible to protect consumers in the subprime mortgage market. The FTC's enforcement efforts would be more effective if civil penalties were available against nonbank entities within the FTC's jurisdiction who violate the rules, a remedy that will be available against entities within the jurisdiction of the Federal banking agencies.[44]

---

[41] Similarly, in a comment filed with the FRB, the Commission stated that, as consumers shop for a mortgage, it is important that they receive timely and understandable information about the loan terms and costs of the particular products they are trying to analyze and compare. Moreover, for many mortgage products with payment schedules that likely will increase substantially in future years, it is important that consumers receive information about their future payments at a time when they can readily use the information in selecting their preferred loan and terms. SEE FEDERAL TRADE COMM'N, COMMENT BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DOCKET NO. OP–1253: UNFAIR AND DECEPTIVE PRACTICES IN THE MORTGAGE LENDING MARKET, ALTERNATIVE MORTGAGE PRODUCTS, AND INFORMED CONSUMER CHOICE IN THE MORTGAGE MARKETPLACE (September 2006), available at *www.ftc.gov/os/2006/09/docketop-1253commentfedreserve homeeqlenditextv.pdf*. The comment was based, in part, on information learned at a May 2006 workshop the Commission sponsored on consumer protection issues associated with nontraditional mortgage products. See Protecting Consumers in the New Mortgage Marketplace, 71 Fed. Reg. 15417 (Mar. 28, 2006); see also *www.ftc.gov/bcp/workshops/mortgage/index.html.*

[42] Truth in Lending, Proposed Rule, 73 Fed. Reg. 1672 (Jan. 9, 2008), available at *http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E7-25058.pdf.*

[43] Similarly, the FTC staff late last year shared with the OTS the Commission's experience in challenging unfair or deceptive acts and practices in the financial services context. The FTC staff filed a public comment with the OTS in response to a request for information about whether the OTS should issue regulations to expand its prohibitions against thrifts engaging in unfair or deceptive acts and practices in mortgage and non-mortgage lending. FEDERAL TRADE COMM'N STAFF COMMENT TO JOHN E. BOWMAN, CHIEF COUNSEL, REGULATION COMMENTS, OFFICE OF THRIFT SUPERVISION, REGARDING SECTION 5 POLICY ISSUE FOR FINANCIAL PRACTICES (December 2007), available at *www.ftc.gov/os/2007/12/P084800anpr.pdf.*

[44] Under the Federal Deposit Insurance Act, 12 U.S.C. Section 1818(i)(2), Federal banking agencies can obtain civil penalties from the entities they regulate who violate the laws they enforce, including TILA and its implementing regulations. The FTC has no comparable authority

Continued

IV. Conclusion

The Commission is committed to protecting subprime mortgage borrowers. The FTC's law enforcement, consumer education, and policy research initiatives in the mortgage market are part of the FTC's broad, vigorous, and continuing program to protect consumers from deceptive, unfair, and otherwise illegal practices. The Commission appreciates the opportunity to appear before you today to discuss the FTC's work.

Senator DORGAN. Thank you very much, Ms. Parnes.

Let me ask you your assessment of the advertisements that I showed in the clip prior to this hearing. Or at the start of the hearing, I should say.

Ms. PARNES. Chairman, I'd prefer not to opine on the specific companies.

Senator DORGAN. Right.

Ms. PARNES. But I can certainly tell you that the types of claims that were depicted in these ads are claims that we would find troubling. These are the kinds of claims that we would certainly pursue. Savings claims often don't reveal all of the hidden costs that consumers face, they're false savings claims. As you've indicated, very low interest rates don't disclose that the interest rate is for a very short period of time, and the disclosures in fine print would not be adequate, as far as we're concerned at the FTC.

Senator DORGAN. Ms. Parnes, how many people work at the Bureau of Consumer Protection at the Federal Trade Commission? How many employees do you have in that Bureau?

Ms. PARNES. We have total employees, we have, I believe it is a little bit under 400, and that includes about 100 people who are in our regional offices.

Senator DORGAN. Has that employment level decreased as it has with the entire FTC over recent years, and the last couple of decades?

Ms. PARNES. I actually—I don't know what the trend has been in the Bureau of Consumer Protection, I do know over the past few years, resources in BCP have increased.

Senator DORGAN. Now, you see what I have shown, and I've shown some charts, and it's pretty clear to me that there is at least deceptive advertising going on, and I'm trying to understand what you all have done to deal with it.

I know that you've brought 22 cases in the last decade, but those cases affect only the case that you bring, right? These are not precedent cases. You bring a case against 22 companies. I guess I'm going to ask you to answer the larger question—as this has grown and become a huge problem with the giant bubble of greed and speculation, why only 22 cases brought by the FTC?

Ms. PARNES. Well, that's a bit of a hard question to answer. I mean, I can tell you, kind of two things. One is that, for the past several months at the Commission we have certainly been questioning ourselves as to whether we could have done more, and what we should do, going forward. It's certainly been a concern of ours.

The other point I would make is that while the subprime mortgage crisis that we're facing right now—and financial practices, generally—is a very significant priority for the Commission. Our

---

to obtain civil penalties from the nonbank entities it regulates for violations of TILA and its implementing regulations.

mission, itself, is incredibly broad. We deal with the entire range of consumer protection issues—deceptive national advertising, we're looking at data breaches, privacy issues, green marketing, I mean, those are just a few of the other issues that we're looking at.

Senator DORGAN. I recognize that the jurisdiction is broad, and as I indicated, I very much support the role of the Federal Trade Commission. You must have a referee in this system of ours. And I know, as I said, regulation is given a bad name, but regulation is critically important to provide the role of referee in this market system.

Because, sometimes events just go out of whack, and that's what's happened here—and I'm trying to understand, as you would see, just as I saw, these advertisements saying, "You've been bankrupt, you've got bad credit? Sole credit? Don't pay? Come to us, we're going to give you some money." And then we started hearing about pre-payment penalties, and subprimes, and so on. Was there any effort at the Federal Trade Commission to say, "Look, something's going on here that is creating a foundation of quicksand that could be a very serious problem for the economy," or did it just not register? Did you do any rulemaking at all? Or attempt to proceed to do any rulemaking?

Ms. PARNES. We did not—we did not do rulemaking. And we did, you know, it wasn't something that we had started. I will tell you, and I—Chairman, I know you understand—that at the FTC, the rulemaking, the procedures that govern our rulemakings are pretty time and resource-intensive. When we have been directed by Congress to engage in a rulemaking, and we've given APA rulemaking authority, and told a time limit has been set for that rulemaking, we've been able to do those rules in a year, sometimes less.

Rulemaking under the Magnuson-Moss rulemaking procedures, at a bare minimum, would take 2 to 3 years.

Senator DORGAN. I understand that, and I'm trying to fix that for you in the FTC reauthorization. But it seems to me no matter how long it takes, one would start a rulemaking if they see substantial abuse.

I just showed you charts of what's on the Internet today—or at least as of 2 weeks ago, when I pulled it off. Do you have people down there, seeing those same things, and taking a look at those companies?

Ms. PARNES. Absolutely. Looking at those companies and others that make the same kinds of claims—deceptive mortgage advertising is an area where we are actively pursuing enforcement efforts.

And I would say that we do certainly hope in some areas that our law enforcement effort has a deterrent impact on the rest of the agency—on the rest of the economy.

The ads that you were showing, these, you know, and some of the other deceptive mortgage advertising ads that we've seen—I'm not sure that it really, truly has a deterrent effect on outfits that are engaging—really trying to scam consumers.

But certainly, as you know, there is a legitimate—there are legitimate businesses out there, and we think for legitimate businesses, when we lay down a marker, we do think that that has an effect on their practices, even if we lay that market down in a case.

Senator DORGAN. But, here we have a situation. I just got the numbers. The FTC, 25 years ago, had 1,700 employees, and now it has 1,000. So, in 25 years, we've cut the agency, by 40 percent. Now we see growing up this set of activities that's far afield from what one would consider to be normal business practices.

I go back to the year 2001 when, I believe it was Mr. Pitt, who was appointed to the Securities and Exchange Commission. I don't have his exact quote, but he essentially said, "There's a new Sheriff in town, and it's a much more friendly environment for business at the SEC." Well, we understood what that meant.

What I'm trying to understand is, why did the FTC—as it began to see what was developing here—why did it pursue only 22 cases over a period, I think, of 10 years, on deceptive advertising, with respect to these mortgages?

Now, I will also admit that these, I think, started probably 7 or 8 years ago, but Mr. Mazzilo and all of the others that, got in the trough here, creating this speculative binge, and making a lot of money while they were doing it—it wasn't exactly out of sight. I mean, we weren't necessarily spending our day thinking about it, or seeing it, but we have agencies that are supposed to do that. So, what failed?

Let me make one additional point—I understand that some of these were outside of your purview, but the non-banks—such as Countrywide and others—about half of them were well within your jurisdiction.

Ms. PARNES. Well, I, you know, I certainly—I understand fully the concern that you're expressing about the actions that we took at the FTC—or the non-action.

Senator DORGAN. Or the lack of them, I'm concerned about the lack of them.

Ms. PARNES. I understand that—I fully understand that. At that time, even though in the financial sector, those 22 cases don't reflect the breadth of the actions that we had taken.

We have a very, I think, fulsome record of law enforcement in other areas affecting consumers' financial well-being, as well. The subprime crisis certainly is having a devastating impact on consumers. And the FTC—we are looking, as you know, at the—at deceptive mortgage advertising. We have other, non-public investigations that are ongoing right now in this area. But there are other practices that affect consumers' financial well-being, and we've been very active in those areas, as well.

Senator DORGAN. Again, I'm going to call on Senator Nelson next, but I want to say that because I can go to the Internet right now and get the same kind of deceptive advertising that is attempting to lure people into bad mortgages. It seems to me the FTC should be apoplectic about that, and holding press conferences and saying, "Don't even think about this. Don't even dare move in this direction, given what we've found with this spectacular collapse as a result of what has happened in the subprime area."

So, I'll come back with another question, but let me call on Senator Nelson.

STATEMENT OF HON. BILL NELSON, U.S. SENATOR FROM FLORIDA

Senator NELSON. Mr. Chairman, to your point, the Federal Trade Commission has the regulatory authority over these kind of lending practices through the enforcement of existing laws. As a matter of fact, the agency retains jurisdiction over non-bank financial companies such as the mortgage brokers, and non-bank mortgage companies, and get this: in 2007, 19 of 20 subprime mortgage lenders in the U.S. fell under the FTC's jurisdiction.

So, the question is begged—why haven't we done this? And what are we going to do about it, in the future? And I just kind of lay the predicate, or set the table here for you.

My state is very much affected. The foreclosures are skyrocketing—you know what the real estate market is like. We had the second highest total of foreclosures nationwide, and four of the top twenty metro areas in the country were in Florida. Fort Lauderdale was 8th, Orlando was 13th, Miami was 14th and Sarasota/Bradenton was 15th.

Of course, many of those in Florida that are facing the foreclosure, were the victims of the abusive and predatory lending practices. And the interesting thing is that some of these victims actually qualified for a better prime loan instead of a subprime loan, and a December *Wall Street Journal* article found that 61 percent of subprime borrowers, if reviewed, had actually high enough credit scores to qualify for the prime loans.

And so, this game was going on where lenders and brokers gave these borrowers mortgages with exploding interest rate payments that they knew that the borrower could not afford, and then they packaged these mortgages in deceptive and confusing ways.

And that's what the FTC has jurisdiction over. And so, what are we going to do about this? Now that we didn't do anything about it, what are we going to do about it on a going-forward basis?

Ms. PARNES. Well, Senator, on a going-forward basis, one of the things that we are very concerned about—we think that consumers that are—who are facing foreclosure are particularly susceptible to mortgage foreclosure scams. And we are participating in regional task forces throughout the country with state attorneys general and other local law enforcers to pool our resources and take action against these entities that are engaging in this type of fraud, and kind of, essentially, adding insult to injury to consumers who have already been seriously injured. So, that's the first thing that we're doing.

As you know, the Federal Reserve Board has proposed a rule that would govern the subprime mortgage market, and it covers the entire marketplace. So, it would cover those entities that fall within the Commission's jurisdiction. We understand that rule will be effective this year, and we will enforce that rule.

Senator NELSON. Now, is that how we're going to draw a clear line between a valid subprime lending, and the predatory lending?

Ms. PARNES. Well, I'm not certain that for purposes of FTC enforcement—I understand the terminology, subprime and predatory lending, but we don't—we're not necessarily concerned with making that distinction. We really look to our statute. And if there is deception or unfairness, we will—we can and will—pursue that actor.

Senator NELSON. Didn't you all go after the practices like bad advertising, and that sort of activity? Is that really going to address the problem? Isn't it going to be that we've got to dig in deeper as to what these people are doing when they cross the line between a valid subprime loan and the predatory lending?

Ms. PARNES. I actually—I think it's both. I think the deceptive advertising kind of lures the consumer in, and as we know, mortgages are extremely complicated transactions for consumers. And if they're being, kind of, pulled in through lies, that's certainly a problem, and that's something that we would want to go after.

But the other practices that you're talking about, the other unfair practices are also problems. And we have pursued them in our cases, we will certainly will continue to do that in the future.

Senator NELSON. The Chairman said that your employment level of full-time employees at the FTC had dropped from 1,700 down to 1,000. Do you need more people to help you?

Ms. PARNES. Well, we certainly—I will tell you that in the Bureau of Consumer Protection we are—we are shifting resources, and we have been doing so for the past, oh, maybe 18 months. We're shifting resources into financial practices, we are growing—we are growing that division. And that's the area that we've asked for additional resources.

So, we appreciate this Subcommittee and Committee's support for the agency in that respect.

Senator NELSON. How many additional people have you asked for?

Ms. PARNES. Senator, I don't recall, I would need to go back and look at the documents.

Senator NELSON. Mr. Chairman, I think to follow up on your line of questioning, we would need that information.

Senator DORGAN. Senator Nelson——

Senator NELSON. Thank you.

Senator DORGAN. Ms. Parnes can't answer your question, frankly, because Mike Parker, a former Congressman, went to work for this Administration and was with the Division of Civil Works of the Corps of Engineers. He came to a Congressional committee and answered the question honestly, "Yes, we need more resources. We don't have the resources to do this," and the next morning he was fired.

Ms. Parnes has a responsibility, I suppose, to support the President's budget request, or she may not have a job tomorrow morning.

So, her answer, I think, was that they're shifting people around. But, the fact remains, in this time of pretty substantial difficulty, we have a good agency but one with 1,000 people, when it had substantially more people, 700 more people 25 years ago, and that's a serious problem.

And I want to make one additional point before I call on Senator McCaskill. The point, I think, Senator Nelson was making, was not just deceptive advertising, which I was dwelling on earlier, but the issue of the mortgage company and the broker that would put a borrower in a subprime mortgage when, in fact, they qualified for a regular mortgage. Putting him in a subprime with pre-payment penalties and so on—that's what made all of this very lucrative.

It's what made the hedge funds, and others, that began to securitize them—the fact that they had pre-payment penalties embedded in the mortgage—very attractive for everybody.

Those were practices, not advertising, practices—in my judgment—that run far afield of what should be acceptable.

And one final point—the Federal Reserve Board rules are out for comment at this point—I mean, I might say, the Federal Reserve Board has been vacant for a long, on vacation on these issues, for a long period of time, and bear substantial responsibility, as well.

But their so-called rules are OK, but they don't do anything with respect to pre-payment penalties, which is a significant problem, but——

Senator NELSON. Which agency, Mr. Chairman, should be looking after that circumstance that you just described. Where they deceptively shove somebody into a subprime loan, instead of where they would qualify for a prime loan?

Senator DORGAN. —there's deception and unfair practices. FTC is involved in both and would have responsibility for both.

Senator McCaskill?

Senator NELSON. Well said.

STATEMENT OF HON. CLAIRE McCASKILL, U.S. SENATOR FROM MISSOURI

Senator MCCASKILL. Thank you, Mr. Chairman.

I think you hear the frustration. I'm a former prosecutor. If we had a crime outbreak in a certain area of Kansas City that involved armed robbery of convenience stores, we would have a cop on the beat, we would know who the cop on the beat was, and we would know how to address that problem.

So far, there seems to be a lack of anyone stepping up and saying, "I'm the cop on the beat." And we want you, Ms. Parnes, to be one of the cops on the beat. And it doesn't appear, so far, that people are taking responsibility for not being the cop on the beat, or really saying, "I want to be that cop."

And let me talk specifically now about the aftermath. As we would say in Missouri, the cow is out of the barn, and we now have to try to clean it up, we now have to prevent these problems from occurring going forward, and one of the things that's happening is that the same people that were vulnerable to these subprime loans, are now vulnerable to the scams that are coming after the subprime loan debacle.

There's a company called Mortgage Shield out of Houston, Texas—are you familiar with this company, Ms. Barnes? Parnes, excuse me. Does that sound familiar at all?

Ms. PARNES. Well——

Senator MCCASKILL. I know you said earlier in your testimony, you didn't want to talk about specific companies, but let me tell you what Mortgage Shield is doing.

They call people in stress situations whose names they are getting, saying they are a loan modification program—that they can help people with a loan modification. Then if you want to hear more, you press 2—and then someone comes on the line and has speaking points. And they give the impression that they can help you at your time of crisis—these vulnerable people. All you have to do is send them $19.95 for the subscription. And if you pay $19.95 for the monthly subscription, they can help you through this mess.

That is just one example, and I'm sure there are dozens and dozens out there, of the vultures preying upon these people in their time of crisis, trying to make a quick buck.

Now is the time for all of those cops that you have—not enough, obviously, and you can't say you need more, or the President will get mad—but all that you have to step up and say, "We are, at least, going to be really aggressive, and high-profile," because you have the deterrent ability. You know, there is deterrence that is possible here. And you know it because you guys have done it in other areas before, when the FTC's authority has been exercised.

And I just hope you all are as exercised. Are you aware of any investigations you have ongoing concerning these companies that are now preying upon these vulnerable people?

Ms. PARNES. These are exactly the types of investigations that we have ongoing. There are—the types, the companies that are preying on consumers who are particularly vulnerable right now, because their homes—because they're in foreclosure.

We have a case that we brought yesterday where consumers whose names were list—consumers were targeted, we allege, by this company because their names were included in public records——

Senator MCCASKILL. Right.

Ms. PARNES.—as, as being—as being——

Senator MCCASKILL. Defaulting.

Ms. PARNES. —exactly. Defaulting on their loans, and these consumers received solicitations from the company that we sued, charging them—not $19.95—but $1,000.00. And promising that they would take then out of foreclosure, and not delivering. And we've sued that company—several others—we have many more investigations underway, and our cops on the beat are participating in regional task forces throughout the country, so that we can work with our colleagues in state and local governments, and really share resources, and leverage our resources, and be most effective that way.

Senator MCCASKILL. I certainly would recommend—I know that you're having task forces, but the people who are losing their homes aren't going to those task forces. I would certainly recommend that you forward information to all of our offices. We get heartbreaking phone calls, every day. Somebody tells the people at the end of their rope, "Well, call your Congressman, call your Senator." And we are fielding calls on a daily basis that make me sick. These people are trying so hard.

I would love it if you guys would begin communicating directly with our offices, so we can send out e-mails to those who have e-mail and so we can send letters to people who have called us with information about some of the scams that you all are looking at, as it relates to these people that are vulnerable, who are looking for any kind of lifeline, and mistakenly are giving people money, thinking they're getting a lifeline, and they're getting nothing.

Ms. PARNES. Senator, we would be happy to do that. We actually have—we have some pages on our website that are specifically geared toward these types of consumer—financial issues. We would be happy to work with your staff, and make sure that your website links to our website, so your constituents can get that information directly.

Senator MCCASKILL. If I might, Mr. Chairman, one more question?

Senator DORGAN. Yes.

Senator MCCASKILL. Thank you. There's another area that has the same danger signals that subprime had. And if you take a helicopter-view of subprime, it was pretty simple. The people who made money on closing the loans had no risk. And when you don't have risk, then you don't care whether people can pay them back, you don't care if it's unfair, you're not going to have an ongoing relationship with this person. It's not like a small community bank. These are people who knew that if they closed the loan, they made the money, and they were done. They washed their hands of it.

The same situation is true in reverse mortgages. The people who are closing reverse mortgages have no risk. Now, what's really kind of scary about reverse mortgages is that taxpayers have the risk. And now these things are being marketed as a government benefit you can't miss. They are being widely marketed—and as you know, Congress wants to take the lid off of reverse mortgages because we make money in our budget to spend.

In the closing cost of a reverse mortgage, there's a fee that goes to the Federal Government, so the appropriators—all due respect, because I know you're an appropriator, Mr. Chairman—we want more money in the budget, and we get money off the closing of those reverse mortgages, but the tale of them is a long tale. It is expensive for seniors, and frankly, a mortgage is not nearly as complicated as a reverse mortgage.

I would like to know, specifically, from you, what the FTC is doing, on an ongoing basis, to look at these reverse mortgage firms and to look at these marketing techniques. I mean, we saw in a hearing that companies were marketing annuities in tandem with a reverse mortgage to 80-year-old people. I mean, no shame. Absolutely no shame.

I am anxious. We've taken some legislative steps to try to correct some of these things, but I'm anxious to get specifics from your agency as to what you're doing because this is the next problem that could occur if we don't get on it now. Shame on us if we don't fix it now, rather than waiting until we've got the kind of problem that we've got with subprimes.

Ms. PARNES. Right. And I think certainly with the changing demographics in our country, it's the beginning of the issue, and you're absolutely right. It's an area that we are getting on, and we would be happy to do further briefings for you, as we move ahead.

Senator MCCASKILL. OK. And we'll try to get you more people next year.

Ms. PARNES. Thank you.

Senator MCCASKILL. Thank you, Mr. Chairman.

Senator DORGAN. Senator McCaskill, thank you very much.

At the risk of injuring your career, I assume that you need more people, and I assume you need the resources to deal with this issue, is that not correct?

Ms. PARNES. Yes, it is correct.

Senator DORGAN. And——

Ms. PARNES. And I hope I'll be here tomorrow—well, maybe not here tomorrow, but——

[Laughter.]

Ms. PARNES.—I hope I'll be back at work tomorrow.

Senator DORGAN. Well, I didn't ask the question to get rid of you, but I appreciate your candor.

Let me also ask you about what I see as the lack of roar—the lack of a national voice coming from the Federal Trade Commission on an issue of its jurisdiction.

Why, given what we now know of these dramatic impacts on the economy of what has happened, the continued advertising still going on—why is the FTC not holding press conferences, not making a big fuss about this, not going to the National Press Club? Maybe you are, and maybe they're not covering it—I don't know.

At least, I hear none of it. I would think you'd be apoplectic about it. This is right in your wheelhouse. Your agency is an agency we fund because we want you up at the plate, taking the swing, and getting rid of this bad behavior. So, tell me why that's not happening? Why I don't see it?

Ms. PARNES. Well, Senator, if you think that we're not making enough noise—we're not. And we need to go back and take a look at that. You know, we're doing—we are bringing cases, we are, we're investigating but, we obviously need to take it up a notch, or two.

Senator DORGAN. The point I was trying to make is that bringing cases is something you should do—but only 22 cases in a decade. There are hundreds, and hundreds, and hundreds of cases out there, I assume. You can't track them down one-by-one. I'm going to try to give you some additional authority in the Federal Trade Commission reauthorization bill, but, in the interim, you still have some capability under Section 5 to take action. And I really hope that this agency will begin to take much, much more aggressive action.

Ms. PARNES. Well, I think we should certainly consider whether even—you know, absent APA authority whether we should be considering a rule to supplement whatever the Fed ultimately issues in this area. And I also think we need to consider additional strategies.

Senator DORGAN. I mean, I don't lay awake at night placing great hope in the Fed. I mean, the Fed is part of the problem here, not part of the solution, regrettably. And had they not been asleep for some of these years, and very interested in ignoring what was happening, we wouldn't be in this situation. I must say, some of the same holds true, I think, for some lack of aggressiveness on the part of the Federal Trade Commission.

Let me just ask a question more specifically—in September of last year, you issued warning letters to lenders regarding their advertising, and the FTC is investigating, as I understand it, more than a dozen mortgage companies as part of a mortgage advertising law enforcement sweep. What's the status of that, and what's the status of the further investigations into advertisements used by non-bank lenders at this point?

Ms. PARNES. Mr. Chairman, those—the status of those investigations are non-public, and so we would have to provide a non-public briefing for you, and we would be happy to do that.

Senator DORGAN. All right, I appreciate that.

Well, thank you for being with us. This Committee wants you to succeed. We want the agency to succeed. We don't want there to be inaction, we want there to be a lot of action on behalf of a regulatory agency that has the tools and the capability to address these issues.

Ms. Parnes, thank you very much for being with us today. We appreciate your testimony.

Ms. PARNES. Thank you, Mr. Chairman. And thank you for your support of the agency.

Senator DORGAN. Thank you.

Next, we will call the second panel to the dais.

Mr. Richard Blumenthal, the Attorney General of the State of Connecticut, Kathleen Keest, Senior Policy Counsel, Center for Responsible Lending—Ms. Parnes, are you able to stay to listen to the testimony? Or do you have to leave? Are you able to listen to a portion of it?

Ms. PARNES. I can stay for a—for a portion——

Senator DORGAN. If you would.

Ms. PARNES.—of their testimony.

Senator DORGAN. I'd appreciate that.

Kathleen Keest, Senior Policy Counsel, Center for Responsible Lending, Ira Rheingold, Executive Director, National Association of Consumer Advocates and Bill Himpler, Executive Vice President, Federal Affairs, American Financial Services Association.

Let me thank all of you for being here, and we will begin today with the Honorable Richard Blumenthal, Attorney General of the State of Connecticut.

Mr. Blumenthal, thank you very much. I believe you have appeared before this Committee previously.

STATEMENT OF HON. RICHARD BLUMENTHAL, ATTORNEY GENERAL, STATE OF CONNECTICUT

Mr. BLUMENTHAL. I have, Senator, and I want to thank you for having me again today on a subject of supreme importance, for Connecticut citizens, for homeowners around the country, and for all of us in both state and Federal Government.

I think a number of the observations made already by yourself and other Senators are extraordinarily pertinent, but I would just respectfully suggest that the legislation you've submitted can lead us to a new paradigm, a new partnership, between state and Federal authorities.

The Federal agencies have been AWOL. Federal enforcement has been lax and lackadaisical. But even more insidiously, the Federal Government has increasingly preempted and blocked the states from enforcing their laws to protect consumers against exactly the kind of predatory and abusive practices that were displayed before us today, and are on display—still, day in and day out.

And my office has prosecuted such cases, we have cases ongoing right now involving major predatory loan schemes in New London, and elsewhere in our own state. And the states were involved in enforcing laws against these kinds of no doc loans, inflated appraisals, other kinds of abuses, before the subprime debacle became a public spectacle.

In fact, the two major cases done by our multi-state task forces produced close to a billion dollars—Household Finance and Ameriquest—two cases that produced close to a billion dollars, as compared to the 22 cases done by the FTC, with about $320 million in restitution for consumers.

So, the States are very much a law enforcement presence, they have been, they should continue to be so, and unfortunately, States have been shackled and subverted by this doctrine and increasing approach of Federal preemption, which is really an arrogant assumption of exclusive power that all too commonly replaces State enforcement with Federal inaction.

It isn't only that the Federal Government is inert. It says to the States, "We know better, and only we can do it, but we choose not to do it," when it comes to consumer protection. And that has been the pernicious approach of many Federal agencies—most prominently, the Office of the Comptroller of the Currency, which culminated in a decision by the U.S. Supreme Court under the National Bank Act in April 2007, *Waters* v. *Wachovia,* which held, in effect, that the National Bank Act precludes States from operating subsidiaries of national banks—those federally chartered banks, even operating as lenders in our States, through their operating subsidiaries, are beyond our regulation, and consumer protection activities.

Your bill, Mr. Chairman, would break that trend. And set a different course toward this new paradigm of partnership, enabling States to be active allies of the Federal Trade Commission and of other Federal agencies in this very, very important activity.

We have suggested, my office, has urged our legislature to ban those pre-payment penalties. Not just in the subprime areas, but for all loans. Because they really imprison homeowners in loans that may be unaffordable, and actually promote foreclosure and default.

We have urged stronger action against the mortgage rescue scams that are now increasingly prevalent, in the wake of the foreclosure increase in numbers. We see, increasingly, a follow up scam, through mortgage rescue promises and claims.

Resources are tremendously important, for both the FTC and the States, and as a prosecutor, as a Federal prosecutor, former United States Attorney for Connecticut, as well as State law enforcement officer, resources are always on my mind, because they are the lifeblood of any successful prosecutorial office.

The Federal role ought to be reconstituted and reconfigured, so as to enable States to play this kind of role, and the combination of State and Federal Government can be very, very profoundly important as a deterrent, as well as a source of restitution.

I think you made this point earlier, that publicity, and public notice form a deterrent purpose. And that is very important, as we've seen in our prosecutorial activities.

The kinds of abuses that we see—one-stop shopping for predatory lending schemes, inflated appraisals, fabricated loans, the no doc loans, the Alt-A loans—typically target first-time homebuyers—

many of them non-English-speaking people, but really across the board. And very often involve bait-and-switch tactics at closings that are inherently deceptive, and misleading.

Let me just close by saying that, I hope that this hearing will lead to additional momentum toward these goals. We have an opportunity—it really is an obligation—to unite Federal and State governments, to end the trend toward Federal preemption, to empower States in protecting their citizens against these abusive practices, and in forming the kind of combination that I think is important.

Because, it is an enduring truth that, when we work together, we do well in protecting people.

Thank you.

[The prepared statement of Mr. Blumenthal follows:]

PREPARED STATEMENT OF HON. RICHARD BLUMENTHAL, ATTORNEY GENERAL, STATE OF CONNECTICUT

I appreciate the opportunity to speak on the timely topic of "Improving Consumer Protections in Subprime Lending."

The steadily worsening housing crisis threatens millions of families from rural, urban and suburban neighborhoods, undermining communities across the Nation. In Connecticut alone, there were more than 3,500 foreclosure actions in just 1 month, putting our state in the top ten.

The ongoing, deepening crisis creates an opportunity—indeed an obligation—for a new, aggressive, innovative effort to fight fraud and protect consumers. The bill before you exemplifies the more vigorous and vigilant spirit that is necessary—uniting Federal and state governments against abusive anti-consumer practices.

There must be a new Federal/state consumer protection partnership—really a renewed and reinvigorated alliance and enforcement paradigm. States have been shackled and subverted by Federal preemption—an arrogant assumption of exclusive power that all too commonly replaces state enforcement with Federal inaction. A new partnership would allow states to enact consumer protection measures concurrently and cooperatively with Federal authorities, provide Federal regulation based on the best state safeguards, and establish Federal/state collaborative enforcement of these consumer protections.

This paradigm has sound precedent. A model would be antitrust enforcement with separate but parallel Federal and state laws and joint enforcement. Others involve Medicaid fraud and deceptive product advertising.

For too long, we have been at odds. Federal and state enforcers and regulators have been in conflict, rather than collaboration. Our message to an inert, inattentive Federal Government has been: join us, or get out of the way. An enduring historical truth is how well we do when we work together.

The Federal role should be reconstituted and reconfigured. States should be enabled and encouraged to do what they do best: efficiently and effectively protect consumers from constantly evolving financial schemes. The Federal Government should review these laws, enacting into Federal regulation the best state consumer protections, applying them across the country as Federal law. A formal joint Federal and state strike force on financial services consumerism would combine the strengths of both—the resources and national scope of the Federal Government with the nimble responsiveness of state government—to help consumers combat fraudulent and deceptive industry practices.

As states like Connecticut are now doing, the Federal Government should specifically ban prepayment penalties, prohibit inflated appraisals, require clear disclosure of key mortgage terms including estimates of taxes and insurance and reasonable projections of future monthly payments for adjustable rate loans. It should compel mortgage companies to demonstrate that borrowers can afford their loans, and require disclosure of concealed fees or charges. It should ban advertising and promotions that are deceptive or misleading.

Lax and lackadaisical Federal enforcement must end. States should be empowered as full partners to enforce consumer protection laws.

At present, rather than encouraging or enabling effective state enforcement, Federal agencies have been an impediment and obstacle. The Office of Comptroller of the Currency (OCC) has continually—and successfully—scuttled state consumer protection laws as applied to national banks, Yet, the OCC has been AWOL during the recent mortgage crisis. The Federal pattern has been to claim sole authority, and then fail or refuse to exercise it.

The Federal Government must stand up and speak out as an aggressive partner with the states in fighting deceptive lending practices, especially affecting subprime loans. The Federal Reserve Board and the Office of Comptroller of the Currency have focused almost entirely on sustaining and preserving the lending industry, rather than fighting serious illegal activities that harm consumers.

The combination of Federal power grab and Bush Administration hostility toward consumer rights created a perfect storm allowing predatory lending to flourish.

As law enforcement officials, state attorneys general have acted where we could. In 2002, Connecticut and 18 other states compelled subprime lender Household Finance to pay consumers almost $500 million for predatory lending practices. In 2006, Connecticut and 48 other states forced Ameriquest to pay $325 million for anti-consumer actions.

But these victories are built on sand as long as we face the huge loophole provided by inadequate Federal regulation and preemption of state law. We were only able to win these settlements because Household Finance and Ameriquest were state licensed, giving the states jurisdiction. Had they been federally chartered, the states couldn't have won a penny for consumers, no matter how gargantuan and glaring their violations of the law.

Indeed, our settlement with Household Finance would be impossible today because the company has since obtained a Federal charter.

I strongly support—as a good first step—the proposed initiative to empower the Federal Trade Commission (FTC) to regulate the marketing of subprime loans and to make the states an effective enforcer of these regulations, along with the FTC. Any such regulations should preserve the authority of states to enact even stronger protections for consumers.

Here, Federal preemption should be explicitly eschewed.

I also urge the Subcommittee to provide immediate concurrent state attorney general enforcement authority over the FTC regulations. States should not have to wait 60 days—as required under the proposed language—to file a lawsuit alleging violations of the FTC regulations. The proposal provides for an exception if the sixty day period is not "feasible." But the meaning of feasible is ambiguous at best. Notice to the FTC of state litigation is appropriate but often states will seek immediate injunctive relief to protect consumers from further harm. Such relief should not be delayed 2 months for notice to the FTC. The proposal should either eliminate the sixty day notice period or provide for broad exception where waiting the sixty days would jeopardize consumers.

States have been at the forefront for many years in combating abusive and deceptive practices pervading the mortgage lending industry—fighting housing loan fraud well before the subprime debacle became a public spectacle.

In our investigations of Household Finance and Ameriquest, we uncovered extensive abusive practices, including inflated appraisals, fabricated income statements, misrepresentations about prepayment penalties and other loan terms, and illegal or deceptive fees and interest rates. Our settlements returned almost $1 billion in restitution to consumers nationwide. Importantly, both companies agreed to follow strict procedures and disclosure requirements, ensuring fairness to borrowers.

In Connecticut, my office's numerous active and ongoing investigations and legal actions have revealed and pursued clearly deceptive and predatory practices:

- "One stop shopping" predatory lending schemes in which mortgage brokers, real estate agents and other co-conspirators combine to sell rehabilitated distressed houses with structural flaws, cosmetically repaired. They typically target non-English-speaking first-time homebuyers with impaired credit. To obtain loans for their victims, they concoct and submit false income information, inflate appraisals, and conceal the actual terms of the mortgage loans from buyers.
- Inflated appraisals resulting from mortgage brokers pressuring appraisers to exaggerate property values by threatening explicitly or implicitly to deny them business.
- Misrepresentation and non-disclosure of loan terms and interest rates and bait-and-switch tactics at closings—typically targeting first-time homebuyers who rely on false assurances from their brokers.
- Abusive foreclosure practices including deceptive and illegal fees—a practice that often impairs the ability of distressed borrowers to reach an arrangement with the lender or mortgage servicer to avoid losing their homes.

States like Connecticut are also taking the lead in developing a comprehensive, hard-hitting, proactive response to this crisis, even in the face of disconcerting and discouraging threats of Federal preemption. Working with key legislative leaders in Connecticut like State Senator Bob Duff and State Representative Ryan Barry, we are crafting legislation to establish a pool of funds that would assist homeowners to stay in their homes by replacing crushing high-cost mortgages with more affordable loans. The legislation will also impose greater responsibility and specific obligations on the lending industry to ensure that borrowers can afford mortgages—even when the interest rates are adjusted. Finally, the legislation will slow the foreclosure process to provide mortgage companies and homeowners with time to reach reasonable solutions that help keep families in homes.

State leadership through proactive homeowner protection can promote a Federal and state cooperative effort with a national enforcement footprint and impact. Federal/state enforcement partnerships are hardly new or novel. Currently, states work in conjunction with Federal agencies on a broad spectrum of cases including Medicaid fraud, antitrust, and deceptive or misleading consumer advertisements. Federal and state law enforcement agencies hold regular regional meetings, exchange investigative information and engage in other cooperative projects. Because many of the companies that have engaged in deceptive lending practices or predatory lending conduct their business in many different states. Federal regulations will assist national enforcement efforts among states and between the Federal Government and the states.

Federal regulations regarding deceptive practices should constitute a floor not a ceiling. States should have the authority to provide stricter and stronger consumer protections. Such an approach has been successfully implemented in other similar Federal laws—from Do-Not-Call regulations to the Truth in Lending Act.

I urge the Committee to favorably consider the proposed legislation to facilitate a renewed Federal and state alliance in this area of significant national and local concern.

Senator DORGAN. Attorney General Blumenthal, thank you very much for your testimony.

Next, we'll hear from Kathleen Keest, who is a Senior Policy Counsel, for the Center for Responsible Lending.

STATEMENT OF KATHLEEN E. KEEST, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. KEEST. Thank you, Chairman, and thank you for inviting me to testify.

I'm going to cut out a lot of what my—I was going to say, because it's very clear from your earlier comments that you really "get it," and don't need to have a lot of the benefit of my explanation of what happened.

And I'd like to just start by saying that I think the provisions in the proposed reauthorization to get rid of the Mag-Moss rulemaking albatross around the FTC's neck would do a great deal of—would remove a great deal of the impediments that they've had to even think about addressing this by rulemaking, and also, the ability for—giving the ability for the State Attorney General's to enforce it would help a lot.

A lot of the State Attorney Generals have the authority under State—have parallel authority under State laws, but some of them didn't, which, in Ohio was a good example of that. Which, I think, is one of the reasons why Ohio started suffering so early, so badly. So, that's going to be a great deal of help, and I want to compliment you for that.

What—as I think you've noticed, or that you've talked about, part of the real problem here is the perverse incentives of the secondary market who paid the originators to push these kinds of risky loans, and push the risk layering. So, I think one of the things that we need to keep in mind in terms of thinking about the problem is that, to some extent we've got a little bit of a parallel to the drug problem. You know, we've got the difference between going after the kingpins on one hand, and the street peddlers on the other hand.

The advertisements out there are sort of the street dealers, bringing the people in. And it's very important, and particularly important for law enforcement to go after that, but on the other hand, as long as the kingpins are out there, and the perverse incentives aren't addressed, to some extent, it's a whack-a-mole game.

And that's by way of saying, that while the FTC, I think, you know, is—it's important to get after these things, this was a systematic—a systemic breakdown. A systemic breakdown of no accountability and no oversight, and a system that led the self-regulating nature that was supposed to be in a marketplace to break down.

And so, there's a limit to what the FTC can do, and—but within those confines, I guess one of the things that I'd like to suggest is that the FTC, one of the things it could do is beef up its use of unfairness. Even if we eliminate deceptive advertising, what happened here, is that the incentives were to sell structurally unfair, and unsuitable products. So, virtually, the only FTC hook they have to do that is to call this unfair—to get at the kingpins, in other words.

And, so I think the FTC, sort of, at the top, you've said earlier that for a long time regulation has been a four-letter word in this city, and to some extent, the use of the unfairness doctrine is one of the things that the industry has been most—I guess I could say angry about. They feel that that's just a way for people to interfere with a business that they know how to do.

Whether or not, sort of, the environment was such that they could have succeeded in using that authority earlier to get at that problem, is sort of a question that it's too late for us to ask.

But the Agency hasn't done a lot with its unfairness authority, and I would suggest that one of the things that this committee can do is—as I think, actually, the Chairman has done today—is encourage it to be more proactive in getting to the root causes of it, which is to destroy the incentives that has made it so profitable for the street dealers to do what they do.

Thank you.

[The prepared statement of Ms. Keest follows:]

PREPARED STATEMENT OF KATHLEEN E. KEEST, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Mr. Chairman Dorgan, Ranking Member DeMint, and Members of the Subcommittee, thank you for the invitation to appear before you concerning what has become one of the most important developments in the U.S. economy in this young century. We have yet to know how many families will suffer the heart-wrenching and economically devastating experience of being forced from their homes and neighborhoods by foreclosure. The most recent estimate is for a total of 6.5 million foreclosures by 2012.[1] The subprime industry itself is decimated, and the Inter-

[1] Rod Dubitsky, Larry Yang, Wen Zhang, Thomas Suehr, *Foreclosure trends—a sobering reality,* Credit Suisse Fixed Income Research (April 23, 2008), *http://www.credit-suisse.com/*

national Monetary Fund recently estimated that direct mortgage losses will exceed $500 billion, and consequential losses could reach nearly a trillion dollars.[2]

At root, it was the industry itself that recklessly abandoned sound business sense, with the consequences to the economy magnified and multiplied through complex financial instruments that spread the infection like a pandemic.[3] There were other factors, of course, but the consequences would have been much more contained had old fashioned common sense and prudence prevailed. Though it was highly profitable for a long while, in the end that recklessness ill-served everyone.

How could it have gone so wrong? How could it have gotten so far out of hand before anyone noticed? Many are trying to sort out what went wrong, and that is as it should be. It is not simply a finger-pointing "blame game" to do so, for an accurate diagnosis is a necessary precondition both for both effectively treating the resulting problems, and preventing a recurrence. The truth is, there is plenty of blame to go around. Many forces came together to bring this economic storm about, and we can't afford to ignore any of them as we look for solutions to today's consequences and preventions for tomorrow. But today, we look at just one of those pieces—one agency among many with some authority in the fragmented system.

My testimony today is on behalf of the Center for Responsible Lending (CRL) (*www.responsiblelending.org*), a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. We are affiliated with a community development lender, Self Help, which provides carefully underwritten subprime loans to people who have been under-served by other lenders. Self Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses, and nonprofit organizations, and our loan losses have been less than 1 percent per year.

In addition to my experience as a senior policy counsel with CRL, I was previously an assistant attorney general in Iowa and Deputy Administrator of the Iowa Consumer Credit Code. This allows me to bring to this testimony some personal perspective on both the possibilities and limitations of public enforcement.

I. Introduction: a Cursory Overview of the Rise and Fall of the Subprime Market

There are many contributors to the meltdown, and far too many players involved to adequately describe in short testimony. But at root, the bottom line is this:

- Far too large a portion of the subprime mortgage industry from its inception has put origination volume ahead of prudent lending practices. Underwriting for sustainability never was its strong suit. Nearly half of all subprime loans originated in 1999 and 2000 suffered delinquencies, and foreclosures were initiated at least once on 1 in 4 to 5 subprime loans originated during those years.[4] But, as we shall see, other factors obscured those early cracks in the foundational fundamentals.
- For a long time, the underlying weakness in the industry was obscured to all but those most closely attuned to that market by at least two factors.
  - First, the share of the subprime market was relatively small, and so ill-effects were relatively contained. Some $138 billion of subprime loans were originated in 2000. By 2006, there were $600 billion in subprime originations, and some $400 billion of "alt-a" which includes many of the nontraditional loans, particularly payment option ARMs.[5]
  - Second, as long as housing prices appreciated, the troubled loans could avoid completed foreclosures by taking the "exit ramps" of refinancing or sale. Ultimately, these loans were paid off—albeit by what is termed "distress prepayment." These "distress prepays," many of which led directly to new subprime or non-traditional originations,[6] disguised the fundamental weaknesses except

researchandanalysis. They estimate 2.7 million total subprime foreclosures and 4 million other mortgages.

[2] Christopher Swann, *IMF Says Financial Losses May Swell to $945 Billion,* April 8, 2008, available at *http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=aK1zAj5FZ9Io.*

[3] *See, e.g.,* Roger Lowenstein, *Triple-A Failure,* New York Times Magazine, p. 36 (April 27, 2008).

[4] Ellen Schloemer, Keith Ernst, Wei Li and Kathleen Keest, *Losing Ground,* p. 13, Table 4, (Center for Responsible Lending, December 2006).

[5] I Mortgage Market Statistical Annual: 2007, pp. 133, 209, 218.

[6] Though the subprime industry often justified itself as a "bridge to prime" for credit impaired borrowers, what data exists does not support that characterization. Subprime to subprime refinancings were more the norm, as far as we know. Although longitudinal studies by bor-

Continued

to those who looked carefully. So, though nearly 1 in 5 of the originations of 1999 and 2000 had a foreclosure filed, only about 1 in 8 went to a completed foreclosure. But when completed foreclosures were combined with "distress prepays," by May 2005, almost 1 in 4 subprime loans originated in those 2 years had failed to prove sustainable.[7]

- The continuing inflation of the housing bubble in some regions of the country, the fact that a large share of the Nation's economy was based on housing and housing-related activity (including consumer spending generated by the "wealth effect"[8]) meant that far too many in public life and the private sector encouraged what, we now see, is a "debt bubble" that underlay the housing bubble.
- The invention of complex financial instruments like "collateralized debt obligations," often rated as investment grade, attracted more investors, vastly increasing the secondary market's demand for these loans. Appetite for the higher-yield instruments—which, as theory tells us, are higher yield because they are higher risk—increased at least in part because other complex financial instruments like "credit default swaps" were thought to insure against the "risk" part of that equation. In other words, the demand for "riskier" investments increased because they thought they could get the higher returns on the upside, while "insuring" against the downside.[9] Subprime securitizations jumped from about $52 billion in 2000 to over $200 billion in 2007, according to Inside Mortgage Finance MBS database.
- The perverse incentives from the "back-end" demand side encouraged the originators to make the riskier kinds of loans, and the voracious appetite from that back-end demand led to a virtual abandonment of fundamental underwriting principles in order to generate loans to feed that appetite.[10] The combination of riskier products and weak underwriting fed off each other in a downward spiral of massive defaults.
- With the bursting of the housing bubble, and declining housing values even outside the "bubble" regions—the "exit ramps" of refinance or sale for troubled borrowers were cut off. And then a feedback loop kicks in—the more housing values decline, the more loans that are caught in the downward spiral, which, in turn, affects housing values of entire neighborhoods, not just the homes securing the troubled loans.[11]

---

rowers are difficult to trace, and therefore rare, what evidence does exist does not support the "bridge to prime" hypothesis. For example, in early 2007, CRL reviewed 106 Option One subprime loans originally written in 2004, and found that three in four refinanced into another subprime loan, while only 1 in 4 refinanced into a prime loan. *"Case Study in Subprime Hybrid ARMs Refinance Outcomes,"* (Center for Responsible Lending, February 21, 2007) available at *http://www.responsiblelending.org/pdfs/subprime-outcomes__2__.pdf*. *See also* Ira Goldstein, *Lost Values: A Study of Predatory Lending in Philadelphia,* Appx. B, p. 74, (The Reinvestment Fund, April 2007) (two-thirds of subprime loans refinanced into other subprime loans), available at *http://www.trfund.com/resource/downloads/policypubs/Lost__Values.pdf.*

[7] *Losing Ground, supra* note 4.

[8] *E.g.,* "[T]he President would like to push it to even higher levels of growth. But there are a number of other factors that go into it: low inflation; high productivity; *low interest rates, which allow the American people to refinance their homes, which puts more money into their pockets, which has been happening to the tune of hundreds of billions of dollars throughout the economy. All of those are causes for optimism about the state of the economy*." (emphasis added.) White House *Press Briefing by Ari Fleischer, January 14, 2003.*

[9] *See, e.g.,* Interview with Prof. Michael Greenberger, *Fresh Air* (NPR April 3, 2008), *http://www.npr.org/templates/story/story.php?storyId=89338743*.

[10] *See, e.g,* Structured Finance in Focus, *The Subprime Decline—Putting it in Context* p. 3, Moody's Investors Service (March 2008) ("The subprime crisis is largely a product of increasingly aggressive mortgage loan underwriting standards adopted as competition to maintain origination volume intensified amid a cooling national housing market."); Interview with Alan Greenspan, *The Oracle Reveals All,* Newsweek, p. 32, 33 (Sept. 24, 2007) (". . . you had Wall Street's securitizers basically then talking to the mortgage brokers saying, 'We'll buy what you've got.' . . . The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime-loan market would have been very significantly less than it is in size.") *Cf* Benjamin J. Keys, Tanmoy Mukherjee, Amit Seru, Vikrant Vig, *Securitization and Screening: Evidence From Subprime Mortgage Backed Securities,* p. 26–27 (January, 2008) (securitization weakens creditors' incentive to screen the loans they make), available at *http://www2.law.columbia.edu/contracteconomics/conferences/laweconomicsS08/Vig%20paper.pdf.*

[11] *See, e.g.*, Dubitsky, et al, *supra* note 1, at p. 6 ("We believe the housing markets in 2008 and 2009 will be under significant downward pressure due to the big rise in forced sales related to new foreclosures and REO properties. . . .")

This is the 2-minute version of the arc of the subprime and nontraditional mortgage meltdown. It was, in short, a systemic breakdown. For purposes of today's hearing, we are focusing primarily on the first item on the list—the abuses and the breakdown of sound business practices in the origination of these loans, and what one regulator could—and could not—do about that. But to understand what happened at that "front-end" of the market, we also have to understand the "back-end" of the market—what Wall Street wanted.

The Supply and Demand(s) of the Subprime Market

Traditional economics thinks in terms of a "supply and demand" curve. But that is not what has been operating in this market, especially over the past five or so years. Instead, the "supply" side—the originators of subprime and non-traditional loans—is sandwiched between two "demand" sides.

"Front-end" Demand	←	"Supply"	→	"Back-end" Demand
Homeowners & home buyers		*Originators & Related entities*		*Secondary Market*

The *"front-end"* demand (in theory) was from refinancing homeowners and home buyers. As a practical matter, however, much of that front-end demand was "generated" demand, not natural demand. In the early years, these loans were overwhelmingly refinance loans, and they were "sold, not bought"—they were loans in search of borrowers, not the other way around. But there was a self-feeding nature to this market, as the originators wished to ensure continued growth through more originations. There isn't a great deal of downside to assuring repeat business for local grocers—in fact, that helps keep those grocers on their toes. But for sellers of debt—debts on which borrowers are contractually obligated—there's a downside to looking for repeat business—trying to get more borrowers deeper into debt and keeping them longer carries with it seeds of predictable, and foreseeable, problems.

Much of the "product" the originators supplied tried to assure that origination volume would "grow." Whether the "packing and flipping" model of old-line finance companies like Associates that was the "dysfunctional" part of the market attracting attention in the early part of this century,[12] or the subsequent standard "exploding ARM"—the 2/28 hybrid ARM that functioned almost like two-year balloon loans—increasing origination volume was the primary goal. For those lenders that sold their loans on the secondary market, the concern with how those loans performed over time was, to too large a degree, "not their problem." Their job was to make loans. It was origination that they were paid for, not performance over time. It was somebody else's problem to live with the consequences—which brings us to the back-end demand side.

More recently, as the housing prices wildly appreciated in some areas of the country, a larger portion of subprime loans (though still a minority) and nontraditional loans were used to purchase homes. But the core problem was the disconnect between houses prices and affordability. The housing affordability index in California in 2005 was just around 14 percent.[13] Though the answer to a housing affordability problem is not unaffordable mortgages, we pretended as though it was, and the same weak underwriting—perhaps even worse—infected the purchase money market.[14]

[12] "Equity stripping through insurance packing, fee-padding, and loan flipping (frequent refinances by the same lender) was the "abuse du jour" as the century turned. Several state legislatures, including North Carolina, enacted state "HOEPAs" that closed the loophole in Federal HOEPA that these lenders exploited; and the Federal Reserve Board amended Federal HOEPA to close one of the loopholes, by making single-premium credit insurance count toward HOEPA's 8-percent fee trigger. On the enforcement side, the Federal Trade Commission brought an enforcement action against Associates (which was purchased by Citigroup during the investigation), settled for $215 million, and the states brought an enforcement action against Household, settling in 2002 for $484 million. It is worth noting that Associates and Household were among the three subprime originators each year in 1998–2002. In 2001, the year before the enforcement actions were settled, they held 20 percent of the subprime market share between them.

[13] In 2005, the average income within the 4th quintile—the second *highest* quintile—was approximately $70,000. Center on Budget Policy and Priorities, Arloc Sherman, "Income Inequality Hits Record Levels, New CBO Data Shows," December 14, 2007, available at *http://www.cbpp.org/12-14-07inc.htm.* In 2005, the median home price in California was $548,000 for an affordability index of 14 percent. State of California, Department of Housing and Community Development, Division of Housing Policy Development, "California's Deepening Housing Crisis," (February 15, 2006) at 2, 6.

[14] With the refinance market, homeowners had both the emotional tie to a home and neighborhood, as well as some equity in the home. "No down payment" home purchase loans meant that the loans were 100 percent loan-to-value from the day they were made. And with products like

Continued

The *"back-end"* demand side was the secondary market—investors looking for investments to buy. The way it let its guard down by creating what it thought of as graded risk, widely dispersed risk, and insured-risk is a story for another day and another hearing.[15] As it relates to the practices of the originators, though the bottom line is that Wall Street valued most highly (that is, paid the most for) precisely the *kinds of products and terms that made the loans most risky for the borrowers.*[16] In short, the secondary market created perverse incentives, and the originators responded to those perverse incentives.

For those who apply common sense, not complex mathematical models, to business, this has been one of the most maddening aspects of the meltdown: the "what were they thinking?" factor. Give it just a moment's thought. There are roughly three categories of default risk: *borrower* risk—the "creditworthiness" of the borrower; *macroeconomic* risks—unemployment, housing prices; *and loan product and term risks.* That is to say, some kinds of loan products and some loan terms themselves exacerbate the risk of default and foreclosure, irrespective of borrower traits.[17] In an industry that claimed to be serving a niche where the "borrower" risks were higher (setting aside the question of steering), common sense would tell a lender to minimize the risk from the other two factors by selling the *least* risky loan products and terms. (That's what the sensible 19 and 20 year olds in an economics class recently said when I put the question to them.) Instead the standard industry practice was to *compound* the risk by making the standard products on the market the riskiest kinds of products—they pushed the products and loans terms that made these loans more, not less, likely to default.

Why would they do that? There are a number of reasons. In part, ignoring underwriting to push a borrower to the maximum on capacity to pay, or pushing an exploding ARM is likely to force the borrower into seeking a refinance later—a new origination. In part, some of the products, like teaser-rate ARMs and POARMs are tailor-made for deceptive sales pitches—low-balling the monthly payments made it easier to sell a complex, risky loan. But the biggest incentive of all was the perverse incentive—the fact that those were the products and terms that Wall Street paid the originators the most for. In the end, it was the "back-end" demand, with its increasingly voracious appetite asking for more and more volume, and paying those originators more for the toxic products than the less remunerative "plain vanilla" products, that drove this market.

That's a birds-eye view of what happened. There was a very long supply chain along the way—from local brokers and settlement agents to national lenders to global investment houses. Deconstructing what happened to oversight, then,—the question of "who was minding the store"—isn't simple. This wasn't "a store"—this was a mega-mall, and lapses in security were everywhere. The unfettered explosion and subsequent implosion raises questions of whether deregulation of both lending markets and investment markets went too far. It raises questions of whether legislators, regulators and the public did have, or could have had, adequate insight into what was happening in time to have stopped it. It raises questions about whether regulators had adequate tools, adequate resources, or adequate will to have done something more. And if not, what do they need for the next time.

Today, we look at only one aspect of this process: the practices of the non-depository originators as they dealt with consumers (the "front-end" demand side): first, how well equipped was the Federal Trade Commission to deal with the problems on its watch, and, second, within the limits it faced, how well did it perform. We believe that for it to have performed optimally, it needed better tools and more resources. But within the confines of those limitations, could it have done more? Probably yes.

---

the non-traditional loans, the only equity to come for some time would be from continuing appreciation.

[15] *See, e.g.,* Lowenstein, note 3, *supra* and Greenberger, note 9, *supra*.

[16] *See, e.g.,* Gretchen Morgenson and Geraldine Fabrikant, *Countrywide's Chief Salesman and Defender,* New York Times (November 11, 2007) ("Investors were willing to pay significantly more than a loan's face value for A.R.M.'s that carried prepayment penalties, for instance, because the products locked borrowers into high-interest-rate loans with apparently predictable income streams.")

[17] CRL's president, Michael C. Calhoun testified to this subcommittee previously about the increased likelihood of default for several kinds of loan terms, such as prepayment penalties and adjustable rates, and the prevalence of risk-layering in this industry, which, of course, simply compounds the risk yet further. See Testimony of Michael C. Calhoun Before U.S. Senate Subcommittee on Interstate Commerce, Trade, and Tourism "Federal Trade Commission Reauthorization," Sept. 12, 2007.

II. "Regulation"—It Comes in Different Flavors

Before evaluating the FTC's performance as a regulator, it is necessary to distinguish among kinds of regulation. As the industry began to unravel, it was common to hear that these loans were mostly made by the "unregulated" segment of the mortgage market—non-depository lenders. In fact, virtually the only major segment of this daisy chain that is truly unregulated is the very tail end—the complex derivatives market.[18] But there are differences in the *kinds* of regulation and oversight to which the various segments were subject. There is *substantive* regulation—the laws and rules that set down the rules of the game. There is *oversight*—routine and regular monitoring that allows regulators on-going access to the regulated industry to keep on top of its compliance. Finally, there is *enforcement*—investigating alleged violations and prosecuting them after the fact.

A. The Underlying Infrastructure: Legal Authority and Political Will

Regulatory agencies are creations of the law, and have only the authority that the law gives them. The *scope of their authority* is set by the law that creates them: The *laws they enforce with respect to the entities within their jurisdiction* are only those that the legislative branch—Federal or state as relevant—enacts. And finally, *the resources they have to do their job with* are determined by their enabling law.

In other words, it all starts with elected officials—here in Congress, and out in the state capitols. An agency may be—and should be—taken to task if it does not use the tools it has to tackle a problem. But if the agency's jurisdiction is inadequate in the first place, it is because the enabling laws make it so; if the laws the agency is to enforce are inadequate, it is Congress and the state legislatures that must act first to strengthen them; if the resources are inadequate, and the agency is funded by appropriations, then it is the body that makes the appropriations that must step up and reassess its spending priorities. As we will see, some, though not all, of the FTC's inadequate responses can be traced back here.

While the tools and the resources must be sufficient, so too must be the will of the agency's leadership. No matter how strong or weak the regulatory infrastructure is, it depends upon the will of the regulator to make the most of what it has. If a regulator—any regulator—believes that the best regulation is the least regulation—then it matters little what the regulatory structure looks like. Regulators must believe in the importance of their job in order to do it right. For nearly three decades, the prevailing political and economic philosophy has been that the markets work best when left alone, with minimal intervention. Whether that was part of the problem, and contributed to a too-weak regulatory response is a legitimate question. It is, however, ultimately is a political question. We will not discuss it today, but only note that it is a question that must be answered at some point.

B. The Legal Tools: The Substantive Law Relating to Abuses in the Subprime and Non-traditional Market

In our 2-minute overview of the root of the problem, we identified a few areas of abuse in the origination marketplace.

Marketing: Sometimes there were misleading advertisements, although often the problem with subprime ads was not misrepresentations about cost or terms, but a complete absence of information about costs or terms. While prime borrowers could easily find information about prevailing rates for "plain vanilla" fixed rate mortgages, there was very little transparency about prices and terms for subprime markets. While advertising rules in the Truth in Lending Act,[19] or general prohibitions against deceptive advertising practices set some ground rules, there was nothing clearly illegal about advertising of what could be called the "'Come into my parlor,' said the spider to the fly" variety.[20] Though some of the "trust us" variety of advertising could be argued to create a fiduciary duty or related duty for originators, this was an area of the law that was in flux through out this period.

Moving from mass marketing to individual sales marketing, there are some specific requirements—mostly regarding disclosures. The Truth in Lending Act requires some early disclosures about loan costs and repayment terms for mortgage lending, and more disclosures at closing. The Real Estate Settlement Procedures Act (RESPA) requires some early disclosures and closing disclosures about closing costs.

---

[18] *See Greenberger, supra* note 9, discussing the Commodity Futures Modernization Act of 2000.

[19] 15 U.S.C. §§ 1661–1665b. These rules do not require that price terms be advertised. If the lender chooses to disclose some "trigger terms," then the rules require some additional disclosures.

[20] *See, e.g.,* Vanessa G. Perry and Carol M. Motley, *Reading the Fine Print: An Analysis of Mortgage Advertising Messages* (working paper, 2008).

But generally, it is simply the prohibition against "unfair and deceptive acts and practices" in commerce that is an agency's primary tool to attack deception in a sales pitches.

Loan Terms and Products: There is little substantive law that governs loan products and terms. In some states, some of the higher-cost, higher fee loans were subject to additional requirements by the "state-HOEPAs," but, for the most part, those laws took aim at the kinds of abuses that were more prevalent in the predominant business models in the late 1990s and early 2000s. In fact, to some extent, Federal law made it impossible for states to squarely address in substance some of the risk-enhancing products. One of the unintended consequences of the 1982 Alternative Mortgage Transaction Parity Act (AMTPA), which preempted state laws limiting "creative" mortgages—like adjustable rate loans and balloon loans, was to encourage the growth of ARMs to take advantage of that Federal preemption.[21] That same law preempted state laws on prepayment penalties from 1996 to July 1, 2003 in most states—another "risk-enhancing term."

Perverse Incentives and Conflicts of Interest: There are few laws in place to effectively address the perverse incentives that led originators to respond to Wall Street's incentives to push the higher-cost, riskier loans. At the beginning of the subprime era, the trade association of mortgage brokers considered themselves to owe a duty to their customers, and some courts had held that there was a fiduciary duty.[22]

But the industry's self-image changed, and it became a legal battle as to whether brokers had a duty to provide their customers with the most appropriate and best loan for them. While individuals could, and did use the common law regarding fiduciary duty, and UDAP claims as a tool, as a clear and potent message to deter such practices industry-wide, it was insufficient. And creditors making their own loans have never had such a duty. As the fundamental problem of putting people into loans ill-suited to their needs and situations, it was only as the crisis became too great to be ignored did state legislatures respond. Since the spring of 2006, several states have enacted laws that specifically impose on originators some kind of duty with respect to their customers.[23] The Federal Government has yet to respond. The Federal Reserve Board has proposed some UDAP regulations pursuant to its authority under the Home Owners Equity Protection Act (HOEPA), but we believe that those rules, if enacted as proposed, would not significantly reduce these perverse incentives.

Weakened Underwriting: The massive failure of underwriting, one of the most fundamental causes of the break down, is the conduct that the existing law was perhaps most inadequate to address. While there is legal precedent to argue that it is "unconscionable" or unfair to make a loan knowing that there is little reasonable probability of repayment,[24] that, too, has been more successful on an individual basis than system-wide. In fact, with respect to the highest cost loans, those subject to the Federal HOEPA, there is a prohibition against a "pattern and practice" of making loans without regard to the ability to repay, but as long ago as 1998, the FRB and HUD admitted that was very difficult to enforce.[25]

Here, too, the recent spate of state laws that began to address the current generation of abuses addressed the need to consider ability to repay. Federal financial regulators issued underwriting guidances for non-traditional loans in 2006, and for subprime loans in 2007.[26] Many state financial regulators adopted parallel guidelines shortly thereafter. The FRB's proposed HOEPA UDAP rules would extend to the subprime market a prohibition against a "pattern and practice" of making loans without regard to ability to repay. However, as the Board admitted a decade ago

[21] 12 U.S.C. § 3801, *et seq.* (This preemption was available to state chartered lenders, not just to federally chartered institutions.)

[22] *See generally* National Consumer Law Center, *The Cost of Credit* § 12.9.2 (3rd ed. 2005). *See esp.* note 686, which quotes an earlier version of the National Assoc. of Mtg Brokers' Code of Ethics.

[23] *E.g.,* Ohio and Minnesota.

[24] *See, e.g.,* Iowa Code § 537.5108(4); cases collected in National Consumer Law Center, *The Cost of Credit* §§ 12.5, 12.7.3.

[25] Joint Report to Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act, Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development (July 1998), at 62–63, available at *http://www.federalreserve.gov/boarddocs/rptcongress/tila.pdf.*

[26] Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58609 (Oct. 4, 2006); Interagency Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569 (July 10, 2007).

that it was a rule difficult to enforce, it seems equally an equally unpromising solution today.

Of the laws that might be applied to the abuses in the market, the primary one within the FTC scope of authority was section 45 of the FTC Act, the Federal UDAP. Though the FTC has authority to enforce the Truth in Lending Act and the Equal Credit Opportunity Act, among others, the nature of the recent abuses were such that its UDAP authority was the primary weapon available to it. However, the FTC's ability to wield that weapon is governed by rules of engagement which make it difficult to prevent abuses.

C. Prophylactic vs. Retrospective Regulation: Prevention vs. Law Enforcement

Regulation can be forward looking—preventative, or it can be retrospective. They can set the standards to be met, and exercise oversight to continually monitor the market to assure compliance. Or it can be retrospective—an investigation begins only after there is reason to believe that violations have occurred, and prosecution follows.

Preventive regulation comes in two forms: *rule-making* and *routine oversight,* that is, regular, recurring monitoring for compliance with the ground rules. The law-enforcement model—the one available to the FTC, is *retrospective.* By definition, it has preventive value only to the extent that the fear of prosecution deters potential violators. In assessing the FTC's performance, it is useful to compare its capacity for preventive regulatory action with that of financial regulators.

1. Rule-making: The FTC's "Mag-Moss" Albatross

The FTC has rule-making authority to define "unfair or deceptive acts and practices" in commerce generally: it is a "generalist" with a scope that encompasses the practices for all of American's businesses—except those that are explicitly entrusted to another agency, such as federally chartered depository institutions. Federal UDAP rule-making authority for federally chartered depository institutions is given to the Federal Reserve (for banks), the OTS (for thrifts) and NCUA (for credit unions.)[27] If the FTC promulgates a relevant UDAP rule, such as one which deals with consumer credit, then the Federal banking agencies are mandated to enact "me-too" rules, unless they determine it is not "unfair or deceptive" when a depository institution does it, or when the FRB deems it would interfere with monetary and payment system functions.

The FTC has promulgated some UDAP rules which have been very important in making the consumer finance marketplace fairer and more honest. Of particular importance is the "preservation of claims and defenses rule,"[28] which assures that lenders that finance merchants can't separate the consumer's obligation to pay from the seller's obligation to comply with the law and contract.

Unfortunately, Congress in 1975 enacted a special rule-making procedure which the FTC must use to promulgate rules defining what "unfair and deceptive practices" are. This so-called "Magnuson-Moss" or "Mag-Moss" rule-making is much more cumbersome, lengthy, and expensive, than the standard agency "notice-and-comment" rule-making procedure prescribed by the Administrative Procedures Act. Just how much of an albatross this "Mag-Moss" rule-making procedure has been for FTC's UDAP rule-making is evident from its experience with the Credit Practices Rule.

It was standard practice in consumer finance contracts to use boiler plate language in adhesion contracts that let the creditors engage in harsh collection tactics—waivers of exemptions even when the credit did not finance the acquisition of the exempt goods, or taking wage assignments. The proposal began internal development in the early 1970s, and the proposed rule was published in 1975. As it happened, this was my first year as a practicing lawyer. Under the Mag-Moss rule-making, industry has an opportunity to turn rule-making into a quasi-legislative process, complete with hearings and the right to cross-examine. My own first foray into the national scene of consumer law was to testify at one of the regional hearings the FTC held on the proposal, in October, 1977, where I was questioned by industry representatives. Fat volumes were published with the report from the hearing and recommendations over the next few years—two, if memory serves. The final rule was published in 1984, to be effective in 1985. There was a legal challenge to the rule from the industry—under Mag-Moss, there are even special rules for judicial

[27] 15 U.S.C. § 57a(f).
[28] 16 C.F.R. § 433, effective 1975.

review of these rules. Finally, some 10 years after it was first proposed, the U.S. Court of Appeals for the DC Circuit upheld the rule and it became effective.[29]

During the process for the "credit practices rule," I went from a totally green new practitioner to a consumer specialist with a decade's experience. Clearly, Mag-Moss' rule-making procedure is not a recipe for a nimble regulatory response to rapidly evolving dysfunctions in the marketplace.

2. Oversight—Routine Monitoring

Another way an agency can get ahead of the curve to prevent abuses or stop them before they get out of hand is through the exercise of oversight authority. The distinction between the regulatory authority over depository lenders and non-depository lenders is particularly stark here, because so much of the root failure here—the collapse of underwriting standards—occurred in the "back offices." Unlike earlier trends in predatory lending—insurance packing and "equity-stripping" which was visible on the face of the consumers' loan documents, failure of underwriting is almost asymptomatic until the failure starts showing up in performance. Asymptomatic, that is, unless it is happens in depository institutions, where regulators routinely examine for "safety and soundness."

To argue that pushing inappropriate loans on borrowers, or failing to underwrite, fell on the "illegal" side of the UDAP law, or in a grey area is one issue the FTC had to resolve for itself, but clearly financial regulators can do so. Because depository institutions hold depositors money, and because those deposits are generally insured by the FDIC, "safety and soundness" oversight is the core mission of financial regulators. Financial regulators therefore have routine access through their examination authority. Whether the financial regulators paid enough attention to both the origination and investment activities of their institutions is a question for another day and another committee,[30] but as to today's question—the FTC, by contrast, does not have this clear "safety and soundness" authority.

In sum, the FTC was not the best equipped agency to engage in prevention. Its UDAP rule-making does not give it the flexibility and nimbleness necessary to response to fast-moving abuses in the marketplace, and it can only act once evidence of a problem surfaces outside the internal walls of the lender, such as from a whistleblower, or an accumulation of complaints. Its preventative capacity, then, is all tied up in whether its enforcement is sufficiently vigorous to act as a deterrent.

3. Law Enforcement—Prosecutions and Deterrence

Earlier in this testimony, I've intimated that the nature of the predominant abuses in the subprime market have shifted over the past decade. The root causes of the most recent crisis we've identified as a massive failure of underwriting and "suitability" (for want of a better word to describe appropriately matching product and borrower).

Before that, the visible abuses were the "packing, stripping and flipping" model. The combination of state laws, the FRB's amendment to add credit insurance premiums to the list of HOEPA's trigger fees, the FTC's enforcement action against Associates and the states' action against Household in fact did send strong deterrent messages to the industry.

Unfortunately, the message received by the industry was—"don't engage in *those particular* abuses." The shift in the kinds of abusive practices was even more problematic, as it turned out. As to the new generation of problem practices, one might offer an explanation for the FTC's caution, if not a justification. The FTC is a "generalist" agency, whose expertise is in general unfair and deceptive business practices and fair competition. The central abuses of the past few years—underwriting and suitability—might have seemed more within the purview of "specialist" financial regulators. Further, absent misrepresentations, those abuses may more properly fall within the "unfairness" rubric. So, while deceptive sales representations are clearly covered by "deception," for an agency that seems uncomfortable in enforcing its unfairness jurisdiction in any case, it is easy to explain an institutional caution about attacking the root abuses with its UDAP authority.

That is not to say that such caution was necessary. Indeed, the states' action against Ameriquest, number one among subprime originators for 3 years before the

---

[29] *American Financial Serv. Assoc.* v. *FTC,* 767 F.2d 957 (1985), *cert den.* (1986).

[30] Arguments that "non-bank" originators were primarily responsible for the shaky practices ignore the extent to which their practices were driven by the "back-end demand" we described earlier. And certainly depository institutions were a part of that aspect, as the losses and write-downs taken by major banks indicate. *See, e.g.,* Todd Davenport, *OCC: Banks Lost $10B on 4Q Trading,* Am. Banker (April 3, 2008). Additionally, some of the highly questionable practices concerning non-traditional loans have come from depositories, *see, e.g., Andrews* v. *Chevy Chase Bank,* 240 F.R.D. 612 (E.D. Wis. 2007), *app. pending*.

states case was completed and publicized,[31] was an example of the states using the parallel state UDAP authority to reach this most recent generation of abusive practices. Even more on point, the Massachusetts Attorney General posed the question squarely, by filing a lawsuit charging that Fremont Investment & Loan's practices were such as to make their loans structurally unfair, in violation of the Massachusetts UDAP statute.[32]

III. Necessary Preconditions for Effective Regulation

For any public regulator to be effective in their role as watchdogs for the public, they require several things:

- *Tools.* They need adequate laws, and the authority to enforce those laws. The UDAP law was the most relevant tool. An aggressive Commission could have done more, but then again, Congress could have provided them both more targeted tools, and more encouragement to take on this industry.
- *Resources.* The FTC is the default agency charged with policing most of the market: everyone not specifically assigned elsewhere is under the FTC's watch, from the major mortgage loan servicers and originators to a mom-and-pop payday store to telemarketing fraudsters to identity theft to purveyors of phony health products. Resources are obviously a problem. But even looking just at this one slice of American commerce, when the business standards of a $600 billion industry fall so far that bad practices are the norm, not the exception, public enforcement resources will be insufficient.
- *Expertise.* At the Federal level, the FTC is the agency with expertise in unfair and deceptive acts and practices. Financial regulators are the agencies with the expertise in the fundamentals of banking and lending.[33] The SEC is the agency with expertise in the secondary market. This crisis implicated all of them. Though the Federal financial agencies coordinated responses, such as the joint guidances, perhaps fragmented oversight kept anyone from looking at the whole picture until it was too late.
- *Undivided loyalty to the public good.* The FTC is funded primarily by appropriations, and is answerable to the taxpayers. By contrast, some of the Federal financial regulators are funded by the entities they regulate, raising the prospect of "regulatory capture." To make matters worse, depositories can choose their regulator—they can choose between state and Federal regulators, and choose among Federal regulators, raising the prospect of "charter competition," as regulators may be unduly soft on their own to capture their own "market share." The FTC, therefore, has no inherent conflict of interest.

IV. The FTC's Enforcement Record on Predatory Lending

As of last September, the FTC had brought 21 actions relating to mortgage lending.[34] It includes actions against some of the major subprime lenders of their day: Associates, First Alliance (in which it cooperated with state enforcement), Delta Funding (also in cooperation with state enforcement), and a servicing case against one of the biggest—and worst—subprime servicers (Fairbanks.) The Associates case began as a broad-based challenge to a wide array of abuses, though the settlement focused just on one of them.

However, as to the core abuses that are more directly responsible for today's crisis, there is less activity—perhaps for the reasons we have described. Though it describes actions relating to deception and misrepresentation against some originators, including brokers, it does not appear to have squarely addressed the present abuses as violations of the UDAP law in and of themselves. The state of Massachusetts, instead, has taken the lead.

Some of its targets illustrate a persistent choice facing public enforcement officials with limited resources: how to prioritize between local actors doing greater harm to fewer people, and national actors doing somewhat less harm, but to many more people. Allocating resources to the former can be a rational choice. But in the mean-

---

[31] After the 2002 enforcement actions against top originators Associates (purchased by Citigroup in 2000) and Household (purchased by HSBC in 2002), Ameriquest shot to the top in 2003, where it stayed until 2005. It alone held nearly 16 percent of the market share in 2004.

[32] *Commonwealth* v. *Freemont Investment & Loan,* No. 07–4373–BLS (Suffolk Cty. Super Ct.), *prelim inj.* Granted Feb. 25, 2008.

[33] It took the OCC 25 years to use its UDAP authority at all, see Julie L. Williams and Michael S. Byslma, *On the Same Page: Federal Bank Agency Enforcement of the FTC Act to Attack Unfair and Deceptive Acts and Practices By Banks,* 58 Bus. Lawyer 1243 (2003).

[34] The actions are described in the Commission's comments to the Federal Reserve Board *Home Equity Lending Market, Federal Reserve Docket* OP–1253 (Federal Trade Commission Letter, Sept. 14, 2006).

time, what appears to be a "lesser harm" but one visited on far more people, can get out of hand. As we are seeing now, the consequences to the economy as a whole can be grave indeed.

In sum, the FTC has done more enforcement than other Federal regulators, despite having less capacity to spot problems early one. However, it could have done more to get to the root causes of today's problem.

V. Recommendations

We appreciate the efforts of Senators Dorgan and Inouye in S. 2831, the proposal to reauthorize the FTC. There are several provisions that we especially welcome:

> *Changes to the Mag-Moss Rule-making.* We particularly welcome Section 9 of S. 2831, which mandates the use of the APA rule-making, rather than Mag-Moss rule-making regarding subprime and non-traditional laws. We recommend, however, that the APA rule-making be used for all consumer protection rules. Section 8 of the bill, gives the Commission the authority to waive Mag-Moss rule-making for any consumer protection rule, but does not mandate the change as it does for mortgage rules. We believe that the current crisis demonstrates that consumer protection regulation is key to protecting an efficient economy—protecting it from wild swings of excess. Congress could send a strong message to the Commission that consumer protection, far from being a "drag" on commerce, is essential to a fair and efficient economy, and that the Commission should be proactive.
>
> *Cooperative rule-making with bank regulatory agencies.* S. 2831 would give the FTC concurrent rule-making with Federal bank regulatory agencies, and requires consultation and coordination "to the extent practicable." We have recommended elsewhere independent and concurrent authority as a result of concerns about regulatory capture. We recognize that there are limits to this committee's jurisidiction, and we welcome the steps taken in S. 2831. We would hope, however, that Congress will make further refinements, to assure that adequate consumer protection rules apply to all lenders. If the bank regulatory agencies do not act when they should, we believe that the FTC should have independent jurisdiction to do so, with due regard for the need for appropriate safety and soundness adjustments for depository institutions.
>
> *State Attorneys General's authority to enforce Federal UDAP law.* Giving state attorneys general authority to enforce Federal UDAP law and other laws within the FTC's enforcement authority with respect to subprime or nontraditional loan is welcome. Adding fifty "cops on the beat" to supplement the FTC's limited resources will be of immeasurable help. While many state UDAP laws provided state AGs with jurisdiction over lending practices, that is not universally the case. For example, until recently, Ohio's UDAP statute exempted mortgage lenders from coverage. Neither Ohio's attorney general nor its citizens had that tool available to them to challenge abuses in the subprime market. Undoubtedly, that was a contributing factor to the serious foreclosure crisis in Ohio.

As we understand the proposed provision that prevents a state AG from exercising this new authority when the FTC has instituted an action,[35] the preemption would not preclude the AG from exercising any investigation and enforcement authority of state or Federal laws that it has pursuant to its own state law. We hope that this is made abundantly clear.

Aiding and abetting liability. In today's complex marketplace, few transactions involve only a consumer and seller of goods or services. Clarifying aiding and abetting liability will help assure that all those involved can be reached by the law.

The bill should include a private enforcement right for consumers. There is one change not present in S. 2831 which we continue to recommend. Congress should provide a private right of action to enable consumers to enforce their own right to be free of unfair and deceptive acts and practices, for the FTC's resources will never be adequate to police the entire market, and public enforcement will never move fast-enough to prevent the foreclosures that are occurring—homeowner by homeowner—all over the country.

Thank you again for providing me with the opportunity to testify today on this important matter. I'm happy to answer any questions you might have.

Senator DORGAN. Thank you very much.

---

[35] S. 2831, Section 11(f).

Mr. Ira Rheingold is Executive Director of the National Association of Consumer Advocates.

Mr. Rheingold, you may proceed.

STATEMENT OF IRA J. RHEINGOLD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES

Mr. RHEINGOLD. Thank you, Mr. Chairman. Like Ms. Keest, I'm going to adapt my remarks, and cut out a lot of what I was going to say, because it's clear that you understand exactly what's been happening in this mortgage marketplace. And I'm going to talk a little bit about what we saw here today, what's wrong with our marketplace, and what some of the solutions, maybe, we need, going forward.

I should offer what my perspective is, because I have been working on this issue for more than a dozen years. I was a legal assistance attorney in Chicago, running a home foreclosure prevention project in the late-1990s, and did that for a number of years.

I now run a project called the Institute for Foreclosure Legal Assistance, where we are funding attorneys from around this country, to fight against some of the foreclosure problems that we're seeing.

I talk—on a daily basis—to the attorneys on the front line, trying to stop foreclosures. I've litigated cases against all of the mortgage lenders, way back in the 1990s. The practices that we're seeing today existed in a lot of low-income communities across urban and rural landscapes in this country for a long time.

What's happened is, it has spread. It has spread to the entire marketplace. And I think it's important, as I speak, I hear the voices of all of the consumers I've talked to over the years—because I've looked at thousands of documents, and talked to thousands of consumers. And I hear the conversations I've had and the interviews I've done with them.

And I think what you got at—but what most people don't understand—is how screwed up the mortgage marketplace really is. It's not our parent's marketplace. It's not our grandparent's marketplace. How many consumers have come to me and said, "But Ira, why would they give me a loan that I can't afford? Don't they make money when I pay my mortgage?" And the fact is, they don't.

And when we see that type of advertising out there, you would think, that loan could not work. Why would a mortgage broker advertise a 1.9 percent mortgage, when in fact, they're not going to make any money, because it's going to expect—the payments aren't going to work for them? Well, the payments do work for them, because the system is broken, and the incentives are completely perverse.

And what happened in the last number of years really is a product of incredible greed—just incredible greed—and a marketplace that was specifically not regulated. The FTC shares some of the blame, but the real blame goes to the Federal Reserve and the Office of the Comptroller of the Currency—I cannot echo Attorney General Blumenthal's remarks any further—they are a culprit in this beyond all imaginations.

What happened was, is that the Wall Street—it reminds me of the movie, *Little Shop of Horrors*. You had this plant, "Feed me, Seymour, feed me, Seymour." And, sort of, everywhere it turned, it wanted more food, more loans, and more product—regardless of whether it was good for the plant, and it was regardless of whether it was the homeowners that were being fed.

And what happened in the marketplace today, was that homeowners were not consumers. There was no transaction that really existed between a mortgage lender and a homeowner. The homeowner was the product. The homeowner was a commodity that was being bought and sold to Wall Street, who could then slice and dice them, and then sell them. And unless we understand that fundamental problem in the marketplace that consumers were products to be sold, as opposed to, consumers who were going to get a fair transaction, we're not going to be able to solve this problem.

One point that you made, I think, is so very important, is that there are good players in the mortgage marketplace. Not as many as there used to be. And I think part of it is what we saw here today.

I look at appraisal fraud as one of the, sort of, systematic of the entire problem. Many appraisers are good people, and wanted to do the right thing, and price things appropriately. Well, guess what? If they priced things appropriately, they got no business. And so, they had to engage in the same practice—because the market encouraged them to do that.

It's the same thing. That small corner bank, you know, in Bismarck, who's offering a loan at 6 percent and 6 and a half percent to their neighbor, "Come in, we'll give you a loan, it's fair, it's affordable, it treats you right, I can make a profit on it." Well, how do they compete against a company who's offering a 2 percent loan? They can't compete, and they fail.

So, the regulation that we need—we need the market economy to work appropriately. And the market economy can only work appropriately, and the good actors can only survive in this marketplace if we have proper regulation. And we haven't had it, and we need it desperately.

The Federal Trade Commission is the one place in our Federal Government—the States have a key role—but the one place in our Federal Government that has consumer protection as part of their mission. And they need to be expanded, and they need to be given more power and more ability to regulate this market.

Thank you.

[The prepared statement of Mr. Rheingold follows:]

PREPARED STATEMENT OF IRA J. RHEINGOLD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES

Mr. Chairman, Ranking Member DeMint, and Members of the Subcommittee, thank you for inviting me to testify before you today about the breakdown of the American home mortgage market and its impact on our Nation's homeowners and communities.

My name is Ira Rheingold, and I have been a public interest attorney for my entire adult career. I have worked in some of our Nation's poorest urban and rural communities and I've witnessed the incredible resilience and optimism that mark the great strength of our Nation's people. I have also seen the incredible fear and despair of Americans faced with the loss of their long-term home and its devastating impact on their families and on their communities.

In the mid-1990s through 2001, I lived and worked in Chicago, where I ran the Legal Assistance Foundation's Homeownership Preservation Project. During those years, I watched (and worked against) the unfair and deceptive practices of all the actors in the mortgage industry, that slowly, but inexorably stripped away the wealth of that city's low and moderate income minority communities. Today, I am the Executive Director of the National Association of Consumer Advocates (NACA), an organization of attorneys and other advocates who represent those very same consumers and communities all across this country. At NACA, I also manage the Institute for Foreclosure Legal Assistance, a project that provides funding and training to non-profit legal organizations that help homeowners negotiate alternatives to foreclosure. In my current roles, I speak to and assist our Nation's consumer advocates who, on a daily basis, meet with and represent the consumers victimized by bad lending practices and see the very real-life consequences of an out of control mortgage lending marketplace. What I see from them are the same unfair and deceptive practices that I personally witnessed in Chicago, except now, those behaviors have moved across all of our Nation's communities. What I hear from their clients is the same fear and despair that I heard all too often on the streets of Chicago. At today's hearing, I hope that you will hear their voices through me, and that you will begin to see what we all need to do to build a rational, robust and well-regulated mortgage market that actually serves the needs and demands of consumers and communities across our Nation.

Introduction

To understand what it has been like to be a consumer attempting to buy their first home, a homeowner attempting to refinance their home for necessary home repairs or to help pay for their children's education or to lower their payment so they could remain in their life-long home on a fixed income, we must first understand how the mortgage market has been working. The mortgage market of the late 1990s and early 21st century, in no way resembled what most of us thought we understood about buying a home or getting a loan. I have talked to literally thousands of consumers, who, until recently, believed (or were led to believe) that the mortgage entity that originated their loan, would only profit when they timely made their monthly mortgage payment. While this may have been the case when our parents or even our grandparents bought their homes, this has not remotely been the truth for more than the past dozen years. Instead, because of the growth of securitization as the tool to fund both prime and subprime mortgages, with all its confusing layers, multiple actors and often perverse incentives, the nature of the consumer-mortgage originator relationship (unbeknownst to the consumer) had fundamentally changed. These changed relationships and backward incentives have led us to the precipice that we stand at today.

Securitization and the Consumer

For my purpose today, I'm going to keep this very simple.[1] At its most basic level, securitization is a process, which involves the pooling and repackaging of cash-flow producing financial assets into securities that are then sold to investors. As securitization grew to be the dominant way that mortgage loans were funded, the role and purpose of mortgage originators (and all the other actors in the mortgage market) fundamentally changed. No longer were mortgage originators, "lenders" who expected (or really cared) about mortgage repayments. Instead, these originators became manufacturers of a commodity, the American mortgage borrower (unfortunately, most homeowners did not and don't understand their role in this transaction). This commodity was then sold to the capital markets, which in turn, chopped, spindled and mutated this new commodity into something that could be purchased by investors from around the world.

While advocates of securitization have argued that the process produced additional capital and greater access to homeownership for some consumers, they fail to recognize the fundamental shift and potential dangers it created in the consumer marketplace. No longer was the borrower's best interest (or even their ability to repay the loan) part of the mortgage transaction calculation. Instead, the real transaction was between the mortgage originator and the investment bank, which not only set the standards for the borrower/product they wanted to buy (and then turn around and sell), but also provided the money for the originators' loans.

Under these set of circumstances, what American consumers needed was the vigorous enforcement of existing consumer protections as well a new set of consumer protections to correspond with the very different mortgage world that had now been created. Unfortunately, what the Federal Government gave us was the exact opposite, not only diminishing its regulation and enforcement of this market, but providing interference and protection (under the guise of preemption) for mortgage

[1] For a much greater detailed discussion, please see Peterson, Christopher Lewis, "Predatory Structured Finance". *Cardozo Law Review,* Vol. 28, No. 5, 2007.

market players when states, recognizing the fundamental flaws in the system, attempted to protect their own citizens.

The Mortgage Market, Unfairness, Deception and the Consumer

Understanding what mortgage originators (and all of the actors in the process) were attempting to do, *i.e.,* create commodities to sell, when they made a loan to consumer helps us understand all the unfair and deceptive practices that have flourished in the mortgage marketplace over the last decade. I'd like to talk about some of those practices now, and explain why they were not caused by a few rogue actors, but were instead a product of the fundamentally flawed marketplace that securitization created and the Federal Government passively permitted to flourish.

A. The Predatory Pitch

As the demand for product to sell to Wall Street investment banks grew (ultimately exponentially), the pitch to vulnerable homeowners (and prospective homeowners) became more targeted and more personal. Armed with financial and personal data and carefully conducted research, mortgage brokers and lenders (and their "bird dogs") used TV and radio advertising, mailings, telephone calls, and even home visits to reel in consumers who otherwise had no real reason to get a new home mortgage. With promises too good to be true ("refinance your home, fix your roof and lower your monthly payment") consumers were later bait and switched to loans far more expensive than they thought they were promised. Because the mortgage "originators" received their full compensation when they manufactured the "product/borrower" to sell onward and upward, there was little concern whether the loan was sustainable. As many of us knew, and most of us have now learned, many of those loans were completely unsustainable.

B. The Over-Inflated Appraisal

In a rational world, a consumer would not want to pay (or borrow) more for a home than what it was worth. In the securitization created "bizarro" mortgage world, an over-inflated house made perfect sense to the parties involved in the transaction (except for the unsuspecting consumer, of course, and maybe the ultimate investors left holding the bag). Let's look at the parties to the transaction. We have the mortgage originator (the broker or the lender or sometimes both) whose incentive is quite obvious. Simply put, the greater the house price, the larger the loan, the greater the fee they will receive from the transaction. (The same can be said for the investment bank). Sometimes the incentives are a little more complicated. Take for instance a homeowner whose existing mortgage is already 100 percent of the actual value of the home. If the real house value was used, no loan could be made, no product could be created. So the house value is increased to meet the loan purchasing parameters (the underwriting guidelines) set by the investment bank and the loan gets made and everyone is happy (including the "unknowing" investment bank who has another product to slice and dice and sell to someone else).

As for the appraiser who creates the fraudulent value for the home, we've seen time and again why they go along with this fraud. Simply, if they actually want to stay in business and continuing doing appraisals, they'll create the value the mortgage originator wants.

What we have left, is a consumer who has a mortgage that is too often worth more than the real value of their home.

C. Yield Spread Premiums and Prepayment Penalties

Unfortunately (for me), I have been around long enough to hear multiple and ever-shifting explanations as to why yield-spread premiums (ysps) are an acceptable practice and why they can work for consumers. I can safely state, that none of those arguments are true in the mortgage marketplace that actually exists in our country. I do however, fully understand why they work for every mortgage market actor except, again—of course—for the consumer.

Let's see. Mortgage brokers get paid more if they produce mortgages with an interest rate higher than what a borrower qualifies for (that, in short is a "ysp"). Unless a mortgage broker actual lives up to their off-stated (but never written) commitment to serve in the best interest of their consumer client, their incentive—a bigger paycheck—to produce a loan with a ysp is clear. Same with the mortgage lender and investment bank, who now have a loan with a bigger interest rate to sell.

To make matters worse, almost any loan with a ysp is sure to have a prepayment penalty. In English, a prepayment penalty is a charge to a consumer who repays their loan "too soon," typically during the first few years of the loan's existence. What makes this product so cynical, and so closely intertwined with a ysp, is that the very existence of the ysp means that the consumer has an interest rate that is higher than they actually qualify for. Therefore, if the consumer acts rationally and shops for a lower interest and enters into a new mortgage, they will be punished with a steep prepayment penalty.

In all my years talking, interviewing, and representing consumers, I have yet to meet that one consumer who actually understood that they were charged a ysp or that the ysp led to a higher interest rate than they were otherwise qualified for. I simply can't imagine how this practice is not deceptive or just plain unfair. Yet none of our Nation's Federal regulators have ever really done anything about it (except to find ways to allow its widespread use).

D. The Disappearance of Escrow Accounts

Because the borrower has become the product to be created and sold, mortgage originators have become experts at getting borrowers to take out loans that make little or no economic sense. A classic and pervasive practice in the mortgage market is the "promise" that a new loan will allow the borrower to pay a lower monthly mortgage payment. What the borrower is not told is that their new payment does not include their taxes and insurance (for escrow), so that their lower payment really is just a mathematical fiction (otherwise known as a lie). While the Federal Reserve now finally appears ready to take some action on this practice, it is ridiculous that this blatantly unfair and deceptive practice (which had been standard operating practice in the mortgage marketplace for over a decade), had never been outlawed or prosecuted by our Federal regulators.

E. Reckless Underwriting and the Rise of Community Endangering Loan Products

In place of an efficient market that provides real consumer choice and rewards consumers for smart credit decisions and rational aspirations, we have seen, in the past few years, a mortgage market that has recklessly created and sold ridiculously risky mortgage products that have excessively benefited all of the market players at the expense of the American consumer and our Nation's communities. In a rational marketplace these loans make no sense. Looking at them however through the lens of our fundamentally flawed and unregulated mortgage marketplace, they unfortunately made perfect sense (at least at the time they were made).

Simply put, in order to meet the product demand of voracious Wall Street investors, originators ignored basic, common-sense underwriting principles in order to boost their loan volume. No doc or "stated-income" loans were great because loan originators made more money (it was less work and they could charge borrowers a higher interest rate) and they fed the beast that wanted high-risk products that would produce a higher return for investors. Underwriting adjustable rate mortgages only at the initial interest rate, without considering how homeowners would be able to pay their loans once the payment adjusted upward, was also quite profitable for mortgage originators and the investment banks that were fed by them. These fundamentally unsustainable loan products, in all their derivations (including 2–28s and option ARMs) were destined for failure and failed they have and we're all now living with the consequences.

But it didn't have to be this way. Many of us saw the current disaster coming, but our voices were ignored. This administration, its Federal regulators and this Congress could have chosen to protect consumers, but instead it sat on the sidelines as our mortgage market came to a predictable crash. My only hope is that we have all learned the right lessons from this current and ongoing crisis, and we move together to build a well-regulated mortgage market that meets the needs of all our Nation's homeowners.

Senator DORGAN. Mr. Rheingold, thank you very much.

Finally, we will hear from Mr. Bill Himpler, Executive Vice President of Federal Affairs, the American Financial Services Association.

Mr. Himpler, welcome.

STATEMENT OF BILL HIMPLER, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. HIMPLER. Thank you, Mr. Chairman. I appreciate you having this important hearing today, and giving AFSA the opportunity to testify. While the scope of mortgage-related issues in the current environment is immense, my testimony will focus on the FTC's role in helping to restore confidence in housing in the mortgage sectors.

Let me state at the outset, that AFSA member companies share your concern—and all of my fellow panelists' concerns—about the growing number of homeowners who are having difficulty making their mortgage payments. We ask the Subcommittee to consider four key points.

First, the voluntary nature of the partnership efforts between lenders and distressed homeowners is very important.

Second, to maintain liquidity, policymakers and regulators must avoid imposing new mandates and policies for mortgage lending that would create uncertainty for investors.

Third, enhancing consumer understanding of mortgage products through educational programs is crucial, and the FTC has been an indispensable partner in this.

And finally, limited Federal resources should be focused to encourage at-risk borrowers to contact their lenders to learn what assistant is available to them.

While relief for borrowers whose adjustable rate mortgages are about to reset, cannot come fast enough, the right way to proceed, and provide relief is through outreach campaigns that are currently underway.

Our Association is a founding partner of the HOPE NOW Alliance, which has provided loan workouts, for approximately 1.4 million homeowners since July of last year. During the first quarter of this year, loan modifications represented 44 percent of all subprime workouts, which is double the rate of last year.

Furthermore, the Federal financial regulators have provided great consumer protection in the mortgage arena. The regulators have strongly encouraged lenders to limit the use of balloon terms, and pre-payment penalties on adjustable rate mortgage products, and called for increased use of escrow accounts in relation to these products.

In addition to cutting rates, the Federal Reserve is expected to publish a final rule in the next 2 months, exercising its authority to ban unfair and deceptive practices by mortgage lenders. HUD has proposed a significant re-write of its RESPA regulations. What's more, States have become more and more aware of the need for more stringent regulation, particularly with respect to mortgage brokers. Thus, whether at the Federal level or at the State level, government is acting to address problematic conduct.

Let me turn briefly to the FTC. AFSA believes that the FTC has been successful in enhancing consumer protection, and has addressed the subprime mortgage crisis in at least two ways.

The first, by using its enforcement authority, under the FTC Act, to pursue bad actors in the subprime mortgage industry. For example, the FTC successfully negotiated a $40 million settlement with Select Portfolio Services, after the Agency alleged that Select Portfolio engaged in unfair and deceptive practices in servicing subprime mortgage loans.

The FTC also entered into a $65 million settlement with First Alliance Mortgage, for making deceptive mortgage loans.

The second way in which the FTC has helped to alleviate the mortgage crisis, is by issuing guidance, and submitting public comments to the Federal banking agencies. In June of last year, the FTC released a Staff Report on Improving Consumer Mortgage Disclosures. The report concluded that improved disclosures would help consumers better understand their loan terms and costs, and that consumer testing is an imperative part of developing effective disclosures.

AFSA believes that the FTC has been effective in enhancing consumer understanding of the mortgage process, and protecting the public against bad actors. However, we also believe that some of the provisions in the reauthorization act will have the unintended consequence of reducing investor confidence, which will ultimately make credit less affordable for consumers.

In particular, Section 5 would expand the Commission's authority to seek civil penalties for violations of the FTC Act, without any prior rule or order by an agency. As a result, a defendant could face civil penalties of as much as $11,000 per violation, based on an act or practice that is adjudicated to be unfair or deceptive for the first time against that very defendant, in that very lawsuit.

The bill would eliminate the current requirement that the FTC involve of the Department of Justice when the Commission seeks to enforce violations of the FTC's rules, or cease and desist orders in U.S. District Court.

However, if a company were to face the prospect of substantial penalties on an act or practice that's never previously been determined by any court or agency to be unfair or deceptive, then review an input by DOJ, would ensure that the act or practice warranted prosecution for civil penalties rather than less draconian relief.

Section 8 would allow the agency—by a majority vote of the full Commission—to promulgate rules on any consumer protections matter, under expedited rules of the Administrative Procedure Act, rather than under the procedures of the longstanding Magnuson-Moss Act. The expedited rulemaking authority could lead to a serious rush to judgment, allowing the FTC to create major industry-wide regulatory changes, without adequate time for business input.

Section 9 of the bill would require the FTC to promulgate an APA rule for subprime mortgage and non-traditional mortgage loans, yet provides no specificity or guidance as to the substance or scope of such rule. This provision is an abdication of the responsibilities of Congress to consider and enact such legislation as may be necessary and appropriate in these areas.

Under Section 11, the bill would give new powers to the State Attorneys General, including the authority to enforce a violation of whatever rule the FTC would promulgate for subprime mortgage and non-traditional mortgage loans. Currently, State Attorney General enforcement of Federal law is limited to specific acts of Congress. Their enforcement actions, involving unfair and deceptive acts and practices, are limited to the State laws affecting the citizens of that State.

If Congress were to give the State Attorneys General the authority to enforce Federal rules and statutes, this could result in duplicative and inconsistent laws based on the same conduct—in other words, we could end up with 50 different interpretations of the same Federal law. It is unnecessary to give this new power to the State Attorneys General, as they regularly join with the FTC in enforcement actions and settlements.

While we appreciate all the Government has done so far to address the mortgage situation, more can be done. We need help in reaching as many homeowners as possible about the importance of contacting their lenders, if they're struggling to make their mortgage payment. Far too many homeowners have not taken this step, often because of ignorance, fear, or a combination of the two. Yet, the sooner these borrowers contact their lenders, the better their chances of finding a workable solution.

Again, AFSA appreciates the opportunity to testify before you, Mr. Chairman, and I'd be happy to answer any questions you may have.

[The prepared statement of Mr. Himpler follows:]

PREPARED STATEMENT OF BILL HIMPLER, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN FINANCIAL SERVICES ASSOCIATION

My name is Bill Himpler, and I am the Executive Vice President for Federal Affairs at the American Financial Services Association ("AFSA"). AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. The association encourages and maintains ethical business practices and supports financial education for consumers of all ages. AFSA has provided services to its members for over 90 years. AFSA's 350 member companies include consumer and commercial finance companies, "captive" auto finance companies, credit card issuers, mortgage lenders, industrial banks, and other financial service firms that lend to consumers and small businesses.

AFSA appreciates the opportunity to provide testimony to the Members of the Subcommittee on the state of the mortgage market, efforts by industry to partner with government agencies and consumer counselors to provide mortgage security to at-risk borrowers, and our members' perspective on policy recommendations currently before Congress. As the Members of the Subcommittee know, the scope of mortgage-related issues in the current environment is immense. Today, however, I will focus my testimony on the role that the Federal Trade Commission has played and can continue to play in helping to restore confidence in the housing and mortgage sectors.

Let me state at the outset that AFSA members share Congress' concern about the growing number of homeowners who are having difficulty making their mortgage payments. Not only do foreclosures affect individual borrowers and their communities, they also affect mortgage lenders, which lose approximately $40,000 per foreclosure.

AFSA asks the Subcommittee to consider several key points. First, I would like to emphasize the importance of the voluntary nature of the partnership efforts between lenders and consumers who face financial difficulty but want to stay in their homes.

Liquidity is equally important in today's tightened credit market. To maintain liquidity, it is imperative that policymakers and regulators avoid imposing new mandates and policies for mortgage lending that would create uncertainty for investors.

Enhancing consumer understanding of mortgage products through personal finance education programs is crucial and the FTC has been an indispensable partner in this effort.

Finally, AFSA believes that limited Federal resources should be used to buttress public and private efforts to encourage at-risk borrowers to contact their lenders to learn what assistance is available to them.

Voluntary Foreclosure Prevention Programs

While relief for borrowers whose adjustable rate mortgages are about to reset cannot come fast enough, AFSA believes the right way to provide this relief is through the outreach campaigns that are currently underway. A paper that describes ongoing foreclosure mitigation efforts is attached to this testimony.

AFSA is a founding partner of the HOPE NOW Alliance that was launched last October at the behest of Treasury Secretary Paulson and HUD Secretary Jackson as a coordinated outreach program utilizing the resources of the lending industry and the credit counseling community. The HOPE NOW plan is designed to help subprime borrowers who can at least afford the current, starter rate on a subprime loan, but will not be able to make the higher payments once the interest rate goes up. HOPE NOW members have agreed on a set of new industry-wide standards to provide systematic relief to these borrowers in one of three ways: (1) refinancing an existing loan into a new private mortgage; (2) moving them into an FHA Secure loan; or (3) freezing their current interest rates for 5 years.

Fourteen HOPE NOW servicers, responsible for more than 33.3 million home loans, or about 62 percent of both prime and subprime loans outstanding nationwide, reported that they provided loan workouts for about 1,376,000 homeowners since July 2007. Of the 502,500 prime and subprime loan workouts that servicers provided to homeowners during the first quarter of 2008, approximately 323,000 were repayment plans and 179,500 were loan modifications. During the first quarter of 2008 loan modifications represented 44 percent of all subprime loan workouts, which is double the 2007 rate.

In addition to HOPE NOW, six major lenders announced the launch of Project Lifeline earlier this month. These servicers will begin the program by providing a letter to seriously delinquent homeowners nationwide. The letter gives homeowners a simple step-by-step approach that, if followed, may enable them to "pause" their foreclosure for 30 days while a potential loan modification is evaluated. The ultimate goal of this step-by-step approach is to find a solution which meets the individual's needs. This is different than the streamlined approach to loan modification announced previously. Subprime, Alt-A, and prime loans may qualify for this program, including second liens and home equity loans.

Current Federal and State Regulatory and Legislative Activity

Furthermore, I call your attention to the activity by the Federal financial regulators to provide greater consumer protection in the mortgage arena. The regulators have provided guidance to strongly encourage lenders to limit the use of balloon terms and prepayment penalties on adjustable-rate mortgage products, and called for the increased use of escrows in relation to these products. In response to calls from Congress to address current mortgage market conditions, the Federal Reserve Board is expected to publish a final rule in the next 2 months in which it will, for the first time, exercise its authority to ban unfair and deceptive practices by mortgage lenders. In its new rule, the Federal Reserve Board is also expected to use its regulatory authority over mortgage lenders to police the activities of mortgage brokers. Moreover, the Department of Housing and Urban Development has proposed a significant overhaul to regulations under the Real Estate Settlement Procedures Act with an eye toward greater consumer understanding of the mortgage process and clearer disclosure of consumer obligations associated with adjustable rate mortgages.

Congress, as well, is considering legislation that would promote consumer protection in the mortgage markets, forestall future abuses and instill consumer confidence back into the marketplace. In addition to the housing stimulus package passed by the Senate earlier this month and being considered in the House as we speak, the House has already passed the Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915 and the Senate Banking Committee is poised to markup the Home Ownership Preservation and Protection Act of 2007, S. 2452 that will address the specific abuses that led us into the current crisis.

States have also been active on both the legislative and regulatory fronts. States have become aware of the need for more stringent regulation, particularly with respect to mortgage brokers, which have received little attention by Federal regulators. These state legislative and regulatory initiatives appropriately target specific practices that are perceived as abusive. This type of regulation both puts the responsible mortgage lenders and brokers on notice of the practices that they must avoid and also provides direction to the secondary market investors who want to avoid purchasing loans from or investing in companies that fail to live up to clear legislative or regulatory mandates. The state legislation also has, for the most part, provided measured penalties for violations of the acts and practices that have been identified as inappropriate.

Thus, whether at the Federal or the state level, we perceive government as appropriately addressing problematic conduct going forward. Legislative committees and regulatory bodies have studied the actions that have led to the current crisis through public hearings and investigations. Unacceptable acts and practices have been identified as such and have been appropriately prohibited or restricted. The result is a developing framework of Federal and state rules that provide clear guidance and assess appropriate penalties if one nevertheless chooses to engage in such activities.

Market Liquidity

Market liquidity is the key to lenders' ability to provide affordable credit to consumers. When credit is tight, the interest rates that lenders can offer consumers rise. After the credit crisis last August, many borrowers with less-than-perfect credit found getting a mortgage loan extremely difficult. However, the Federal Reserve Board's recent rate cuts have improved liquidity and made credit more affordable. Market liquidity should continue to improve and help abate the current housing crisis provided that lenders and investors can be assured of which acts and practices are prohibited.

FTC: Effective Regulator

The FTC has been very successful in addressing the subprime mortgage crisis and enhancing consumer protection under its current authority. The FTC has addressed this crisis in two ways: first, by using its enforcement authority under Section 5 of the FTC Act to pursue bad actors in the subprime mortgage industry, and second, by setting Federal policy through guidance and public comment. The FTC successfully negotiated a $40 million settlement with Select Portfolio Services (formerly known as Fairbanks Capital Corporation) in November 2003. The FTC alleged that Select Portfolio engaged in unfair and deceptive practices in servicing subprime mortgage loans. Under the terms of the settlement, Select Portfolio agreed to pay $40 million, which the FTC in turn distributed to consumers as redress. The settlement was modified in August 2007 to provide additional protections to borrowers, including mandatory monthly mortgage statements, a five-year prohibition on marketing optional products such as home warranties, and refunds for foreclosure attorney fees for services that were not actually performed. The FTC also entered into a $65 million settlement with First Alliance Mortgage Company for making deceptive subprime mortgage loans. The FTC alleged that First Alliance misrepresented the existence and amount of origination fees and increases in interest rates and monthly payments on adjustable rate loans. The settlement included payment not only by First Alliance, but also by Brian and Sarah Chisick, the founders and owners of First Alliance. The FTC distributed the $65 million to nearly 20,000 affected borrowers. These are just two examples of successful FTC enforcement actions concerning subprime mortgage lending. The FTC has successfully pursued other subprime mortgage lenders engaged in what the FTC deemed to be inappropriate conduct, including Capital City Mortgage Corporation and Quicken Loans, Inc.

In addition to pursuing bad actors in the subprime mortgage industry, the FTC has helped to alleviate the subprime mortgage crisis and improve mortgage lending practices by issuing guidance and submitting public comments to the Federal banking agencies. In June 2007, the FTC released a *Staff Report on Improving Consumer Mortgage Disclosures.* The FTC conducted a study on the effectiveness of mortgage loan disclosures and found that current disclosures do not adequately explain mortgage loan terms and costs to consumers. The FTC concluded that improved mortgage loan disclosures would help consumers to better understand their loan terms and costs, and that consumer testing is imperative in developing effective disclosures. The FTC has also submitted public comments to the Federal banking agencies on numerous occasions, setting forth the FTC's position on various issues. For instance, on the issue of mortgage disclosures, the FTC submitted comments to the Federal banking agencies in response to their Proposed Illustrations for Consumer Information for Subprime Mortgage Lending. The FTC commented that consumers would benefit from a single disclosure that consolidates the disclosure of important features and costs of a mortgage loan. Additionally, based on its own mortgage disclosure research, the FTC encouraged the Federal banking agencies to conduct consumer research to ensure that the proposed disclosures would be effective.

In sum, the FTC has successfully addressed and helped to curtail abuses in the subprime mortgage industry through its current enforcement authority and its role in developing Federal policy.

FTC Reauthorization Act of 2008

As I noted above, AFSA believes that the FTC has been effective in enhancing consumer understanding of the mortgage process and protecting the public against bad actors. Moreover, we have been proud to partner with the FTC on a number of these efforts. However, AFSA believes that some of the provisions in the FTC Reauthorization Act of 2008 will have the unintended consequence of reducing investor confidence, which ultimately will make credit less affordable. I would like to take a moment to explain our principal concerns.

Section 5. Civil Penalties for Violations of the FTC Act

This section would expand the Commission's authority to seek in U.S. District Court civil penalties for violations of the FTC Act, and it would give the FTC power to seek these penalties without any prior rule or order by the agency. As a result, a defendant could face civil penalties of as much as $11,000 per violation, based on an act or practice that is adjudicated to be unfair or deceptive for the first time in the lawsuit against the defendant.

Today, in court actions involving initial determinations that a particular practice is unfair or deceptive, the FTC is limited to injunctive and monetary relief and the equitable powers of a court to redress demonstrated consumer injury. Civil penalties are reserved for violations of a rule or a final cease and desist order with actual knowledge or knowledge fairly implied that the act or practice is unfair or deceptive and is prohibited by the rule or is unlawful under the FTC Act. Thus, civil penalties essentially punish a defendant for a law violation when the FTC can prove that the defendant knew that the practice was not only unfair or deceptive but was also prohibited by an exiting rule or order.

Given the Commission's very broad mandate to address "unfair or deceptive acts or practices," no company should face the prospect of civil penalties for an act or practice until there has been a prior determination that the act or practice is unfair or deceptive and the company has had actual knowledge of that determination. That is why FTC civil penalty actions in U.S. District Court under Section 5 of the FTC Act are reserved for violations of rules or cease and desist orders. This process provides appropriate notice, not only to the target of the FTC enforcement action, but to the industry as a whole, and lets market participants reform their practices before facing crippling fines and penalties.

The requirement of knowledge that an act or practice is "unfair or deceptive" is based on the fact that these terms are very broad, susceptible to differing interpretations and applied to many different industries. "Unfairness" is a particularly evolving standard, in both the FTC's interpretation and its use in enforcement actions. For example, the FTC has applied the unfairness standard in settlements against holders of credit card data that suffered security breaches. In settlements with BJ's Wholesale Club, Inc., Life is good, Inc., and TJX, the FTC alleged that the failure of these retailers to adequately safeguard customers' personal information, which ultimately led to security breaches, constituted unfair practices under Section 5. These settlements resulted in orders requiring the retailers to develop and maintain adequate security information programs and safeguarding practices. Had the FTC been empowered to seek civil penalties of up to $11,000 for each violation in these cases, the settlements could have had a crippling effect.

Section 3. Independent Litigation Authority

The bill would eliminate the current requirement that the FTC involve the Department of Justice (DOJ) when the Commission seeks to enforce violations of FTC trade regulation rules or cease and desist orders in U.S. District Court. As noted above, violations of those rules or orders may result in the defendant paying civil penalties to the government. In addition, when the FTC seeks civil penalties under statutes such as the ECOA, COPPA or CAN–SPAM, the agency must notify the DOJ, which has the right to bring the case itself. Because the FTC is currently limited to seeking civil penalties for rule or order violations or for specific statutory violations, the DOJ has not exercised that right, and for those kinds of enforcement actions, the opportunity for DOJ involvement may be less important. However, if the FTC were also given the authority to seek civil penalties based on an alleged unfair or deceptive act or practice, as discussed above, DOJ oversight would be crucial. If a company were to face the prospect of substantial penalties for an act or practice that had never previously been determined by any court or agency to be unfair or deceptive, then review and input by the DOJ would assure that the act or practice warranted prosecution for civil penalties, rather than less draconian relief. For that reason, there should be no change to the current requirement that the FTC involve the DOJ in civil penalty actions.

Section 7. Liability for Aiding and Abetting

The bill would make it unlawful to "aid or abet another person violating any provision of this Act or any other Act enforceable by the Commission." There is no definition of "aid or abet"—terms that are usually used in a criminal context.

Section 8. Permissive Administrative Procedure for Consumer Protection Rules

This section would allow the agency, by a majority vote of the full Commission, to promulgate rules on any consumer protection matter under the expedited rules of the Administrative Procedure Act (APA), rather than under the procedures of the Magnuson-Moss Act. The expedited rulemaking authority could lead to a serious "rush to judgment," allowing the FTC to create major industry-wide regulatory changes without adequate time for business input and thoughtful consideration.

The Magnuson-Moss rulemaking requirements, which have been in effect for more than 30 years, provide procedural safeguards that are appropriate when a Federal agency is given a broad mandate to proscribe by regulation "unfair or deceptive acts or practices" in interstate commerce. When applied to the Commission's consumer protection mission, "unfair or deceptive acts or practices" can be, and has been, interpreted very broadly. Without adequate opportunity for concerned public input, the agency could promulgate rules that are based on subjective notions of unfairness or on an incomplete understanding of an industry or of the full consequences of a rule. When Congress gave the FTC substantive rulemaking authority in the Magnuson-Moss Act of 1975, it included procedural safeguards against these dangers. As a result, Magnuson-Moss rulemaking procedures require more than just the "notice and comment" requirements of the APA. They also require the FTC to conduct public hearings and to give interested parties an opportunity to present data, views and arguments and conduct cross examination of the witnesses. Any final rule must be based on the rulemaking record, and published with a statement of basis and purpose. The final rule is subject to review by a U.S. Court of Appeals. It is noteworthy in this regard that, in at least two instances, a Court of Appeals overturned the FTC's final rule as unsupported by the record. In many other cases, the Magnuson-Moss rulemaking process led the FTC to decline to publish a final rule or to promulgate a more reasonable rule than originally proposed. Thus, the deliberative process inherent in Magnuson-Moss rulemaking has served the public interest well.

The FTC has promulgated APA rules from time to time pursuant to a specific Act of Congress, such as under the Telemarketing and Consumer Fraud and Abuse Prevention Act and the FACTA amendments to the FCRA. In those cases, however, Congress specifically delineated the scope of the FTC's authority. Absent such statutory restrictions, there would be inadequate limits on the FTC's authority to define unfair or deceptive acts or practices.

FTC rules establish industry standards, proscribe conduct and carry significant civil penalties for violations. For these reasons, it is imperative that the rules be promulgated in accordance with the procedural safeguards of the Magnuson Moss Act.

Section 9. Rulemaking Procedure for Subprime Lending Mortgages and Nontraditional Mortgage Loans

The bill would require the FTC to promulgate APA rules for subprime mortgage and nontraditional mortgage loans. The bill provides no specificity or guidance of any kind as to the substance or scope of such rules. The provision is nothing short of a complete abdication of the responsibilities of Congress to consider and enact such legislation as may be necessary and appropriate in these areas.

Section 11. Enforcement by State Attorneys General

The bill would give state attorneys general the authority to enforce a violation of whatever rule the FTC would promulgate for subprime mortgage and non-traditional mortgage loans (as provided for in Section 9). In addition, state attorneys general could enforce violations of the Truth in Lending Act (TILA) or the Home Ownership and Equity Protection Act (HOEPA). The bill would also give the state Attorneys General the authority to enforce the provisions of the FTC Act or any other Act enforced by the FTC with respect to violations of the FTC rules for subprime mortgage and non-traditional mortgage loans and for violations of TILA or HOEPA. Thus, the bill would empower state Attorneys General with all the authority and remedies currently available to the FTC, including injunctive relief, monetary damages, restitution and other consumer redress.

Currently, state attorney general enforcement of Federal law is limited to specific Acts of Congress. State attorney general enforcement actions involving unfair or deceptive acts or practices are appropriately limited to the state laws affecting the citizens of that state. If Congress were to give the state Attorneys General the authority to enforce the Federal rules and statutes, the result would be the creation of new Federal requirements and prohibitions based on state enforcement actions. State attorney general lawsuits enforcing the Federal law could result in duplicative and inconsistent lawsuits based on the same conduct. Such lawsuits would undermine the Federal standards under the FTC rules and Federal statutes. Moreover, state unfair or deceptive acts or practices statutes often provide that they are to be interpreted consistently with the Federal law. As a result, a state attorney general action could create new law in other states, as well as under the Federal law.

It is unnecessary to give state Attorneys General this new power. As a matter of practice, the state Attorneys General regularly join with the FTC in enforcement actions and settlements. When they do so, however, each attorney general proceeds under its own state law, which is how it should be.

Personal Finance Education Programs

Part of the solution must also include consumer education programs that equip potential homeowners with a clear understanding of the mortgage lending process and the tools that are available to them in choosing the mortgage product that best meets their financial needs. AFSA's Education Foundation (AFSAEF) has produced a world-class personal finance curriculum, MoneySKILL®, which aims to help high school students meet the financial challenges that lay ahead. MoneySKILL is a highly interactive, reality-based Internet curriculum. The course consists of 34 "how to" modules on income, money management, spending and credit, and saving and investing. MoneySKILL is used by educators in all 50 states and several other countries. More than 80,000 students have enrolled in the program. AFSAEF also plans to translate MoneySKILL into Spanish and undertake a campaign to encourage the Latino community to use this curriculum.

In addition, AFSAEF has developed an educational mortgage brochure, available in both English and Spanish, in conjunction with AFSA and the American Association of Residential Mortgage Regulators. The brochure contains worksheets to help consumers shop for the best mortgage deal and determine an affordable monthly mortgage payment. A glossary defines basic, but important, loan terms, such as Annual Percentage Rate, finance charge, balloon payment and arbitration clause.

Borrower Contact with Lenders

As you can see, lenders are working successfully with credit counselors to help at-risk borrowers stay in their homes. Where we need help is reaching as many homeowners as possible about the importance of contacting their lenders if they are having difficulty making their mortgage payment. Far too many homeowners have not taken this step, often because of ignorance, fear, or a combination of the two. Yet the sooner these borrowers contact their lenders, the better their chances of finding a workable solution.

As this committee considers how best to assist at risk borrowers, we encourage you to augment the private sector's efforts to convey this important message. In particular, the U.S. Treasury Department's Office of Financial Education and/or the newly created President's Advisory Council on Financial Literacy may be ideal places to conduct these kinds of campaigns.

Again, AFSA appreciates the opportunity to testify before Subcommittee on the state of the mortgage market, efforts by industry to partner with the government agencies and consumer counselors to provide mortgage security to at-risk borrowers, and our members' perspective on policy recommendations currently before Congress.

Senator DORGAN. Mr. Himpler, thank you very much. First of all, I appreciate you being here, and I might say to you, the last thing you should lose sleep over is that the Congress would rush to judgment about anything.

[Laughter.]

Senator DORGAN. This is not a body known for speeding. And my hope is that we will begin to take some effective action soon.

First of all, I thank all of you for providing, in many ways, different viewpoints about a very controversial issue. Mr. Himpler, yours are perhaps more different than the other three, I might say.

Mr. HIMPLER. I noticed that too, Mr. Chairman.

Senator DORGAN. But, let me ask, if I might, Mr. Himpler, first—you saw the advertisements that I used on the clip and you saw what I was able to pull off the Internet at the moment. Are companies that would advertise like that able to be a member of your organization? In other words, do you have any self-regulation inside your organization?

Mr. HIMPLER. Yes, we do. We have best practices and voluntary standards that all of our—our member companies must meet. I will say that the Countrywide was the only lender that I noticed in both the charts that you had and the advertisements on the screen.

Senator DORGAN. And Countrywide, for example—there have been stories—and I have not documented them personally—but I've seen stories in major publications that talk about the number of mortgages that were written by Countrywide for borrowers who qualified for non-subprime loans but were put into subprimes with pre-payments and so on. When that happens, does your organization have any mechanism by which you're policing these standards?

Mr. HIMPLER. We have an Executive Committee that reviews those matters and makes advisements to our board. But, I will say that as a best practice—this goes back a few years ago now when the House was considering predatory lending legislation in the last Congress, a number of our members, on our Mortgage Advisory Board, sent a letter to Congressman Kanjorski, specifically addressing that very issue of steering, and have made it a best practice of our association not to.

Senator DORGAN. But from what we now know, the largest mortgage lender in America was pretty busy steering.

Mr. HIMPLER. I don't know how old that—the advertisement that you had was up, and I don't know the time-frame under which you're speaking, Senator.

Senator DORGAN. Attorney General Blumenthal, you heard Mr. Himpler say that if we have Attorneys General involved in the various States, enforcing a Federal rule, you'll have a mess on your hands. Respond to that, if you would?

Mr. BLUMENTHAL. Well, I think the bad guys will have a mess on their hands. The kinds of ads that you've seen here will be pursued before they become a template for the failure of the system.

You know, the argument that there will be duplicative actions, we'll have 50 different interpretations, you know, I've heard it for 18 years, it just doesn't happen. It's a false argument. Because what happens really is, that Attorneys General work together, as we did on *Household Finance,* where 19 Attorneys General brought an action under our consumer protection laws, which are largely identical, or *Ameriquest,* where all 50 Attorneys General brought actions based on our consumer protection laws.

Now, we could bring those actions, then. Now, *Household Finance* has chartered itself or licensed itself federally, so it would be beyond our jurisdiction today. But we recovered in Household Finance for consumers and States about $484 million, because we recovered for excessive interest rates, unconscionable fees, abusive pre-payment penalties, unnecessary insurance charges—all the kinds of abuses that we then found in *Ameriquest,* where we recovered $325 million, and all the same practices that we see today. And I would second Mr. Rheingold's observation, that what has happened is, that those abusive practices have migrated. The cancer has metastasized into the general business practices in the industry.

There are, by in large, hard-working, honest people in this business, but like any cancer, if it's not checked, it will grow and kill the person, the patient. And that's what we're seeing in the seizing up of all our credit markets.

As you have observed, now the effects are rippling and spreading through the economy. The disconnect between the loans and the ultimate owner of those loans is now so complex that not only is the market undermined, but it is impossible to unravel the loans. And as much as everyone wants some relief provided to homeowners, it is a challenge to know how to do it because the ultimate owner of that loan is so disconnected from the homeowner.

And I might just make this last point, because we're involved and we get the same argument that you've heard here this morning on anti-trust, where we now have an investigation underway into the sales of those investment instruments that sliced and diced and securitized—investigations because the buyers of those securities, we believe, may have been mislead and deceived as to how secure they were. And, that potential deception involved not just the investment banks, but also the credit rating agencies, and others in this industry.

So, there's a lot of work to do here, Mr. Chairman. And the argument that State should be barred from enforcement simply because there would be more of it, and it would be uncontrolled centrally, I think is profoundly fallacious.

Senator DORGAN. So you're opposed to it.

[Laughter.]

Senator DORGAN. Ms. Keest, let me ask you—you heard the testimony of the Attorney General about his belief that pre-payment penalties "should be abolished." I'm going to ask Mr. Himpler about pre-payment penalties in a moment, but what is your assessment of the role pre-payment penalties have in all this?

Ms. KEEST. I would say that pre-payment penalties had, sort of, three key roles in there.

First, and the most obvious one, is that they locked people into bad loans. What often happened when people got in with deception, you know, the logical thing to do once they figured it out was to try to get out as quickly as possible, but those pre-payment penalties locked them in. That part of it is visible and that we all saw fairly early on.

The part that was more part of this whole structural, fundamental problem, is that—that it became part of steering, it became part of making loans more expensive at both the front and the back ends for consumers, and it became part of the incentive—the perverse incentives. Which is to say that, because Wall Street liked pre-payment penalties, Wall Street not only paid the brokers more for loans with pre-payment penalties, but they then penalized brokers by reducing the amount of what's called yield-spread premiums, which is sort of the rate back—the kick back they get out of the rate—by reducing that, if the broker delivered them a loan without a pre-payment penalty.

So, pre-payment penalties are integrally involved in, sort of, the structural unfairness of these loans. And, they are often justified as a way of buying a, you know, sort of lower rate, but the data indicates that's not there.

Senator DORGAN. As I understand, a pre-payment penalty is this: The way the system has worked is if you have a mortgage with a pre-payment penalty, and it's a subprime mortgage that resets at a higher interest rate than normal, then attach a pre-payment penalty to that, and then securitize it and cut it up and sell it someplace, embedded in that new security is a pre-payment penalty, which guarantees the higher rate will follow the security through its life.

So that makes it more attractive to hedge funds. It makes it more attractive to the system in which you sell the security. That gets back to the proposition that the lender no longer has the loan.

The borrower comes to the lender and says, “I’ve got a problem here, can we work on it?” And they say, “Well, I don’t have your loan.”

And they can follow it in many cases through two or three sales, which transfers risk, transfers the asset, which is now a security. And you can’t really unwrap or unravel it for a lender to be talking effectively to a borrower.

So, what I’d like to hear from you, Mr. Himpler, is the issue of how these pre-payment penalties developed. Have they been around for a long time? And how do they play a role here in helping guarantee the reset at the higher interest rate under subprime that makes Wall Street happy?

Mr. HIMPLER. Well, I’m glad you asked if they’ve been around for some time, because I think this story does go back some time. Essentially what we’re talking about in the subprime arena and securitization, is a story that goes back 15, 20, maybe even 30 years. It wasn’t too long ago that we were—maybe 20 years or so—that if you had blemished credit, you were essentially shut out from the American Dream.

We took credit from an on/off switch, if you will, to a, more of a dial type of mechanism, whereby lenders can price for risk. That allowed a number of folks that fit into the subprime category to be able to buy their first home.

Essentially, in order to preserve the investment that they had, to have greater certainty about the cash-flow that’s associated with a subprime loan, investors wanted pre-payment penalties, to ensure that they—they were putting up their money for a certain number of years, they wanted to make sure that they had a cash-flow from that investment for the years that they were putting up. That’s essentially where it comes from.

They can also be used to buy down interest rates. Despite my friend Kathleen’s reports, we’ve also got studies that pre-payment penalties do, essentially, afford borrowers to get a lower interest rate over the life of the loan.

The—generally speaking, pre-payment penalties don’t last over the life of the loan. More importantly, the good news, if you will, is that as of last year, the Federal financial regulators, as well as the State financial regulators, which followed suit under subprime mortgage guidance, have essentially limited the scope of pre-payment penalties so that they must expire before a first reset of a mortgage interest rate.

Senator DORGAN. Mr. Rheingold, I want to ask you about the general proposition here. My understanding of the general proposition has been that—seeing these advertisements and seeing the money that’s involved in this stream—you can essentially attract someone who doesn’t have perfect credit and perhaps may have filed bankruptcy or may have not particularly good credit, and say to them, “We will provide you a mortgage.”

In fact, some of this, represents cold calls to a home of someone who already has an existing mortgage they’re perfectly happy with. This cold call from a broker says, “We have a mortgage where you pay no principal in the first period. In fact, not only do you not have to pay principal, but also you don’t have to pay a portion of the interest, so no principal and only a portion of the interest. And by the way, you don't have to document your income."

Is that the case? I mean, that's what I've read. Is it the cast that that's the kind of sales technique that would put a mortgage out there in the hands of a borrower who's pretty unsuspecting about the consequences of all of that?

Mr. RHEINGOLD. It's kind of mind boggling, isn't it?

Senator DORGAN. It is.

Mr. RHEINGOLD. But in fact, that's exactly what's happened.

Again, those advertisements—those products really are a symptom. There were people who wanted to buy those loans, because they were high-yield and high-risk loans. It had nothing to do with what was best for the consumer.

I think one of the things that's happened in our country, when you look at those products, when you talk about somebody in bankruptcy or who had bad credit, is we've gotten away from, sort of, the traditional notion that it's good to save, that you need to have some money to put down into your house, that your house is not your bank, that in fact, putting money down, earning enough money, making sure you buy a house that fits into your budget, are good things.

And instead, what we've turned around, because there was this voracious appetite for mortgage loans, we created these ridiculous products that were destined for failure, not because it was good for our economy, not because it was good for our neighborhoods or community, and certainly not because it was good for our consumers, but because we had a beast that needed to be fed. And that was completely wrong.

And I think all of those things, I mean, all of those ads, all the things we see daily, the credit card ads that you see that keep encouraging people to get into debt. The notion that you should get a loan that allows you to pay less, that allows your home to get—to be negative amortizing, that your principal continues to go up—is absurd.

It may work for a few people. That product was designed for one point, sort of, it's not the products that kill, it the people who sell them that kill. There's a market for that product, right? If you're a really sophisticated consumer and you want to pay less on your mortgage because you've got all these great investments, and instead of having to pay five, you know, you don't want to pay it at 7 percent interest, you're going to go stick it in some bonds and make 20 percent, you're going to invest that money, maybe that loan works for you. But for the average American consumer, that product is insane.

And the fact is, is that nobody understood what they were getting, or at least, unless they were sort of speculative investors and that's still a small portion of the mortgage borrowers, people did not understand any of this. They had a chance to pursue the American Dream, it was sold hard to them, and they were told they could buy the house of their dreams with this loan, and they fell for it, and they had no protection.

Ms. KEEST. Mr. Chairman?

Senator DORGAN. Yes.

Ms. KEEST. Could I supplement——

Senator DORGAN. Yes.

Ms. KEEST.—something that he just said? It sort of relates to the fragmented nature of the market. What we saw from Countrywide was their ads for the payment option ARMs. Countrywide is such a big organization, that it has different kinds of lenders within it, including non-bank lenders and bank lenders.

And, I don't know whether this was routine or not, but the Countrywide payment option ARMs, like those that were advertised, that I saw, made in 2005, were made through the national bank that Countrywide had, not through the non-banks. Now, whether that was their practice routinely or not, I—or whether it was an accident of what I saw, I don't know.

But one of the things that I think, you know, is interesting about the fragment—fragmented nature of the oversight is the question of whether or not they were in—with that kind of a product and that kind of advertising, they were less afraid of the Federal regulator—Federal banking regulator than they were of the FTC and the State Attorney Generals. I would be interested in knowing that.

Senator DORGAN. Well, someone once said, the problem isn't the arrow, it's the archer.

[Laughter.]

Senator DORGAN. And in many ways that's the case here. We can get rid of bad practices, bad products, deceptive advertising, we can—but it's the culture here that has grown up in recent years, in which there is, to quote Ross Perot on another subject, "There is a giant sucking sound, it seems to me, coming from markets that want to securitize almost everything and move them along." I call it an area of dark money these days because the financial engineers have found really unique and almost unbelievable ways to securitize almost everything, and the transparency is gone for a lot of it.

We should ask ourselves, how is it that the biggest firms on Wall Street, presumably with these unbelievably smart people, have lost so much money because they didn't understand what my parents and your parents would understand: if you're going to provide a home loan to somebody, it ought to be to somebody that might have a reasonable chance of being able to make monthly payments. I mean, that's not high finance, that's basic.

[Laughter.]

Senator DORGAN. So, we're trying to understand what has happened here, how to change it, how to shut down the bad practices, how to make sure it doesn't happen again because the consequences of this are pretty staggering. The consequences are economy-wide and everybody is affected. This practice helped exacerbate the housing bubble, and its collapsed now, has——

Mr. HIMPLER. There were a lot—there were a lot of practices.

Senator DORGAN. —there were a lot practices, but this was an accommodating practice, for sure. And, as I said, I was going to—Mr. Rheingold, give you a chance to give due credit to the Office of the Comptroller of the Currency—you just mentioned it briefly. It deserves, it really deserves more mention, perhaps, at this hearing.

Mr. RHEINGOLD. Sure. They do—there was a special place for them, there really is. I mean, this was a bank regulator who not only did nothing, as the world was falling apart around them, but they stopped everybody else from doing something. It really, there's no words to describe.

I'm a private attorney, a legal services attorney, I work as a non-profit attorney. We brought cases, we knew what was going on here, we saw all of the bad practices. I've seen this for a dozen years. And in case after case where private attorneys bring cases, you can be sure the OCC is going to step in and say that State law doesn't apply to my national bank, let alone what they did to States Attorneys General. It is an absolute—they should—they should be ashamed of themselves.

Senator DORGAN. Let me ask briefly—the legislation that I have proposed, reauthorizing the Federal Trade Commission—generally, are you supportive of that, Mr. Rheingold?

Mr. RHEINGOLD. Absolutely.

Senator DORGAN. Ms. Keest?

Ms. KEEST. Yes.

Senator DORGAN. And, Attorney General Blumenthal?

Mr. BLUMENTHAL. I do as well, and if I might just——

Senator DORGAN. Yes.

Mr. BLUMENTHAL.—address a couple of points.

First of all, as you may have gathered, I join in the general opinion that has been expressed about the OCC, but there are a bunch of other Federal agencies, including the Federal Reserve, and a number of Federal supposed enforcers that have been completely AWOL here. And, just to repeat, have not only seized complete power, but also blocked others from exercising any power, and failed to use it themselves.

But, I want to, because it might be my last chance to speak, come back to a point that you raised at the very beginning, who's at fault? You know, obviously, some of the pushback to you, in your debate, when you aggressively seek the kind of legislation which I do support, the reauthorization bill that would provide stronger enforcement, more resources, will be—well, "You know, the home owners should have known it was too good to be true. You know, who gets a mortgage for a fraction of a percent of 2 percent?"

Well, you know, Mr. Chairman, what we've seen at the ground level, what we see in ordinary consumers, the real lives, is that they are persuaded, they don't need an attorney of their own, they don't need a home inspector, they don't need any sort of independent advice that would help them evaluate all that squiggly fine print that you see on the screen here and that mortgages typically include as well.

And often, what we found in *Ameriquest,* for example, and what we've found in our local predatory loan schemes, is that the deal has changed when the consumer appears at the closing. Often he is literally moved into the house with his family or he's sold—he's moved out of the other house or he's sold, sometimes sold the house that he had. And literally, on the verge of the closing, the terms are changed, as a kind of bait-and-switch.

So, this idea that the consumer should have known, I think is—is also fallacious, and I think that it also defeats the argument that the markets should be allowed to work without any regulation, without any intervention, because the markets are simply not working if there is deceptive and misleading pitches and practices.

And, I would just conclude by saying, one of the reasons why I think that this bill is so important, is, you know, we have a lot of laws on the books, if they're not enforced, they're dead letter. And that's the problem with a lot of the best Federal laws, that the Federal agencies responsible for enforcing them simply aren't doing so, and I think this bill should send a message to them and send a message to the industry that there will be real penalties.

I differ with the view that was expressed earlier about penalties being excessive in this bill. We need stronger penalties and we need to see them imposed, otherwise they'll be seen as simply the cost of doing business. And, the bad guys in this industry, even if they're just a minority, will give everyone a bad name and do harm to the economy.

Senator DORGAN. Attorney General, thank you very much.

And, Mr. Himpler, I would say—I asked the others about the FTC Reauthorization bill. I noted your objections in your testimony to the bill.

Mr. HIMPLER. Is it possible for me to——

Senator DORGAN. Yes, of course.

Mr. HIMPLER. OK. A couple comments, I know it may surprise Attorney General Blumenthal, but to a certain extent I agree with some of his comments. Our association doesn't have any problem with the borrower having independent representation at settlement to make sure that they understand the mortgage contract that they're undertaking. We think it's vitally important and we're committed to that.

On the issue of securitization, let me be the lone voice that says that I still think it plays a very vital role in our financial services sector. It's—we're talking about a phenomena that has taken place over the last 10 to 15 years. No one would say that Fannie and Freddie should stop securitizing. We do need to learn some lessons. I stand shoulder to shoulder with you, Mr. Chairman, in the need for transparency in that area, but I think it's still a vital piece of the puzzle.

Senator DORGAN. I learned a lesson about these things some while ago when we had a major flooding disaster. An entire city was evacuated and there were small business disaster loans provided by the SBA to people who had suffered greatly.

And later, when some issues arose, we tried to track back on these loans, and they were sold by the SBA, so it wasn't a case where even a Federal agency could sit down with the person who had borrowed the money because they'd sold it. And I was one of the most surprised people around trying to understand that even the Federal Government had gotten into some of this act.

Well, I want to thank all of you for being here and providing information. I thank Ms. Parnes for listening to the testimony as well. I want the Federal Trade Commission to do well. I want us, as a Congress, to try to think through and understand what has happened and what we must prevent from happening again, and how we put this back on track to represent the kind of home mortgage lending we would expect.

The housing industry is a very big industry in our country. The dream of owning a home is an important American Dream. And the notion of financing it is one of the most complicated things that happens in the life of a consumer, and we need to get this right. It got far off track and we need to bring it back.

I thank all of the witnesses for being here today.

This hearing is adjourned.

[Whereupon, at 12:18 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. OLYMPIA J. SNOWE, U.S. SENATOR FROM MAINE

Thank you, Mr. Chairman, for holding today's hearing on how the Federal Trade Commission's (FTC) oversight of subprime lenders can be more effective. I am appreciative of Chairman Dorgan's steadfast efforts to combat these flagrant abuses. I also welcome the expert witnesses who will testify today about the impact of predatory lending on American consumers and how the FTC can better regulate this industry to both help us get out of the current housing crisis, caused by the subprime lending grist, and to prevent the next crisis from occurring. I am particularly interested this morning in hearing comments on steps we in Congress could take to broaden the FTC's oversight authority over unscrupulous mortgage lenders.

I am deeply concerned that it could take the FTC up to 10 years, under the Magnuson-Moss Act, to put out "new" oversight rules. Because this Act prescribes a rulemaking procedure which requires the FTC to accept oral testimony, evidence, and make fact-finding determinations, we might be in our *next*—heavens forbid—housing crisis before the FTC is able to put out a "new" rule. We in Congress need to help arm the FTC with as many weapons as possible to combat and rectify the *current* housing crisis, and streamlining the FTC's present method by moving to Administrative Procedure Act (APA) notice-and-comment rulemaking will help speed up the process.

To comprehend the devastating effects that predatory loans are having on our economy, it is imperative that we understand the magnitude of mortgage difficulties facing our Nation. By 2009, more than a trillion dollars of mortgages originated during the subprime lending boom will reset to higher interest rates. *Currently, according to the Mortgage Bankers Association, subprime adjustable rate mortgages (ARMS) constitute 42 percent of foreclosures started during the fourth quarter of 2007.* This exceptionally high number is expected to skyrocket over the next year once the subsequent wave of adjustable loans reset and borrowers' mortgage payments increase by 30 to 50 percent. *In December 2007, the Center for Responsible Lending predicted that 2.2 million families with subprime loans will lose their homes to foreclosure because of recent predatory lending.*

The FTC must vigorously fight against the type of predatory lending that is forcing so many Americans into foreclosure and causing many to lose their homes. For most Americans, their home is the single largest investment and their retirement nest egg! Unfortunately, though the FTC has information warning consumers about predatory mortgage schemes dating back to 1998 on its website, the Commission does not have specific rules for regulating the non-bank lenders that account for many of these predatory loans.

The FTC's job is to protect consumers against unfair or deceptive acts and practices. Our experience with subprime lending has taught us that we in government must work to prevent similar crises from occurring. While I commend the FTC for bringing 21 actions against companies and principals in the mortgage industry, as well as monitoring advertisements for illegal claims over the last few years, I wonder if these activities are enough?

Frankly, the enormity of the subprime mortgage crisis begs us to question why the FTC has not *already* promulgated rules to regulate non-bank lenders and if the FTC has sufficient authority to oversee non-bank lenders, such as mortgage brokers?

I am especially concerned with the calamitous consequences of unfair predatory lending that continue to affect borrowers in my home state of Maine. According to a recent report on subprime mortgages by Coastal Enterprises Inc., predatory lending in Maine is dominated by out-of-state non-bank lenders and mortgage brokers that are subject to fewer regulations than Maine-based brokers. The report *estimates that Maine families will lose at least $23.4 million **annually** because of equity stripping from predatory mortgage lending. And this figure does not include foreclosure costs!!*

On Friday, March 7, 2008, the *Portland Press Herald* reported that, according to the Mortgage Bankers Association, *Maine's foreclosure rate is 2.36 percent of homes, above the national rate of 2.04 percent of homes.* This rate is expected to only increase over the next few years. While not all of Maine's foreclosures are directly attributably to predatory lending, it makes me curious as to how Maine would have faired without those iniquitous, predatory loans.

High foreclosure rates harm communities, creates blighted areas, and stunt local and national economic potential. Consequently, it is in the best interest of all of the parties involved in the subprime crisis—the banks, the investors, and the borrowers—to act to preserve homeownership and minimize foreclosures.

In that vein, we should consider any and all measures to assist the FTC to more vigorously regulate the conduct of non-bank lenders. Our current economic downturn threatens the stability and vitality of our economy. The FTC must take every action within its power to reduce predatory lending and protect consumers against these onerous practices. It is my fervent hope that this hearing with provide us answers on how the Congress can empower the FTC to better accomplish these goals.

Thank you, Mr. Chairman.

MORTGAGE BANKERS ASSOCIATION
Washington, DC, April 28, 2008

HON. BYRON DORGAN,
Chairman,
Subcommittee on Interstate Commerce, Trade, and Tourism,
Senate Commerce Committee,
Washington, DC.

Hon. JIM DEMINT,
Ranking Member,
Subcommittee on Interstate Commerce, Trade, and Tourism,
Senate Commerce Committee,
Washington, DC.

Dear Chairman Dorgan and Ranking Member DeMint:

The Mortgage Bankers Association [1] (MBA) greatly appreciates the opportunity to comment on the record for the April 29 hearing at the Senate Committee on Commerce, Science, and Transportation's Subcommittee on Interstate Commerce, Trade, and Tourism concerning S. 2831, The Federal Trade Commission (FTC) Reauthorization Act of 2008.

MBA supports the FTC's regulatory efforts respecting lenders not regulated by Federal financial regulators and the efforts of the FTC and Federal financial regulators to stop abusive lending. MBA unequivocally regards abusive lending as a stain on the mortgage industry that should be dealt with effectively in a uniform manner.

MBA is concerned; however, that the provisions in S. 2831 may lead to unnecessarily burdensome and overly costly regulation of the mortgage market that may undermine uniform regulation. MBA strongly believes judicious regulation and a uniform national lending standard are the best means of providing consumers innovative financing choices, increased competition and lower costs. MBA has the following comments on the specific provisions of the bill.

Section 3 would increase the FTC's independent enforcement authority by removing the necessity for the FTC to provide a 45-day opportunity for the Department of Justice to bring a civil money penalties case on behalf of the Government before the FTC brings a case of its own. Under current law, the FTC can already go directly to court for injunctive relief, redress or monetary damages. Actions under the FTC's authority are grounded in its Section 5 "unfair and deceptive acts and practices" (UDAP) authority which is vague and can be applied very broadly. Considering this, MBA believes the provisions under current law, which establishes a "check" for the Department of Justice, further the objective of assuring there is clear and consistent enforcement government-wide.

---

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's website: *www.mortgagebankers.org.*

Section 5 would significantly broaden the FTC's authority to seek civil money penalties including penalties under its UDAP authority. This would pertain even where the FTC may have provided little or no guidance for companies regarding what constitutes a violation. The penalties provided for in this section, up to $12,000 per violation, may compound rapidly for behavior that may not have been thought to be illegal. MBA believes statutes with vague terms should not have significant penalties. Such statutes increase compliance costs, reduce competition and ultimately result in higher costs to borrowers. Statutes that clearly define and proscribe misbehavior may be coupled with penalties as a deterrent.

Section 8 would provide the FTC the option, by a majority vote of the full Commission, to promulgate rules on any consumer protection matter under the expedited rules of the Administrative Procedures Act (APA), rather than under the procedures of the Magnuson-Moss Act. While other agencies may utilize the APA, they do not have the broad jurisdictional reach of the FTC or its broad, and at times vague, UDAP authority. MBA is concerned, considering the UDAP standards involved coupled with increased civil penalties for violations, that the FTC's powers may be overly increased by this change.

Section 9 would provide the FTC authority to conduct rulemaking proceedings with respect to "subprime mortgage lending and nontraditional mortgage loans." MBA believes assigning the FTC this authority may invite additional rules inconsistent with those of other Federal financial regulators. This problem would be further exacerbated by the fact the bill does not define either the term "subprime mortgage lending" or "nontraditional loans." Without further guidance, it would be left to the FTC to define these terms and the scope of its rules, independent of any definitions promulgated by the Federal banking regulators now or in the future. The fact that this provision would invite varying regulation coupled with increased penalties and jurisdiction provided elsewhere in the bill, would, in MBA's view, result in unnecessary costs to the industry and ultimately to consumers.

Section 10 would broaden the FTC's authority by making all Federal banking agencies, not just the Federal Reserve and the Federal Home Loan Bank Board (now the Office of Thrift Supervision), subject to the FTC Act. Under these provisions, whenever the FTC prescribes a rule concerning an unfair or deceptive practice, the agencies would have to adopt a similar rule within 60 days of the effective date unless the agency finds the practice is not "unfair or deceptive" or there is a finding implementation of similar regulations with respect to banks, savings and loans, or Federal credit unions would conflict with essential monetary and payment policies.

While MBA appreciates the bill would require regulations be prescribed jointly "to the extent practicable," MBA does not believe the bill would go far enough to ensure consistency or provide sufficient authority for Federal financial regulators to determine that an FTC rule should not be implemented.

Section 11 would allow state Attorneys General, with 60 days notice, to bring cases under the FTC Act to seek civil penalties, disgorgement or injunctions against bad actors for certain actions. These actions would include enforcement of a violation of a subprime mortgage lending rule or a nontraditional mortgage loan rule, or a violation of the Truth in Lending Act (TILA) or the Home Ownership and Equity Protection Act (HOEPA) with respect to subprime mortgage lending or a nontraditional mortgage loan.

Under current law, state Attorneys General regularly work with the FTC and other government regulators to bring a wide range of actions using state consumer protection laws consistent with Federal law. MBA does not believe there is a need to provide for a direct action by state Attorneys General under Federal law and is concerned authorizing such action would simply invite widely diverse and inconsistent theories and interpretations of the law which will countermand efforts at greater uniformity. Adding to this concern is the fact actions may be brought in any district where a lender or related party operates; it is also not clear whether state actions would be able to be brought under these provisions as well. Finally, as a practical matter, the notice provision would allow little "check" to ensure consistency. FTC is unlikely to have the time or resources to regularize lawsuits across the country.

Again, MBA appreciates the opportunity to provide comment to the Subcommittee and welcomes the opportunity to recommend specific changes to improve the bill as it moves through the legislative process.

Sincerely,

STEPHEN A. O'CONNOR,
Senior Vice President, Government Affairs.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. OLYMPIA J. SNOWE TO LYDIA B. PARNES

Question 1. According to the Federal Deposit Insurance Corporation (FDIC), non-bank lenders are primarily responsible for predatory mortgage loans. Even though the Federal Trade Commission (FTC) has oversight authority over nonbank lenders, to date it has not published a broad rule for overseeing this industry or regulating subprime lending. The Federal Trade Commission has known about problems with predatory mortgage loans for at least 10 years. On the Federal Trade Commission's (FTC) website, there is a document entitled "Home Equity Loans—Borrowers Beware" which was published by the FTC in April 1998. Knowing that predatory lending is an ongoing problem, why has the FTC failed to promulgate a rule to govern non-bank lenders? If the Congress doesn't enact Senator Dorgan's proposal, which would allow the FTC to promulgate rules under the Administrative Procedures Act (APA) will the FTC ever issue a broad rule to regulate predatory lending and the conduct of non-bank lenders.

Answer. The Commission has had to decide how best to focus its efforts to protect consumers in the subprime mortgage lending area that has expanded so rapidly in recent years. As primarily a law enforcement agency, the Commission found that focusing its resources on law enforcement allowed the agency to target new and evolving harmful practices, obtain redress for injured consumers, and obtain injunctive relief to ensure that those companies did not continue to violate the law. At the same time, these actions put industry on notice of how the Commission was applying the laws it enforces to subprime lending and servicing practices. For example, in *FTC* v. *Associates First Capital, Inc.,* the FTC challenged as deceptive a large subprime mortgage lender's practice of including single-premium credit insurance in loans without disclosing its inclusion to consumers.[1] After the defendants agreed to pay $215 million in consumer redress to settle this and other allegations, major subprime lenders discontinued the sale of such insurance.

Focusing on law enforcement has enabled the agency to challenge practices as they are discovered and as they change. Based on that law enforcement experience, we found that those practices varied from case to case, and over time. In contrast to law enforcement, the Commission's rulemaking procedures are burdensome and time-consuming, making it difficult to address evolving practices in a timely manner.

The Federal Reserve Board appears likely in the near future to issue comprehensive new rules under the Truth in Lending Act ("TILA") and the Home Ownership Equity Protection Act ("HOEPA") which would apply broadly to subprime loans; many of these rules would apply to all mortgage loans. If the Board's rules are finalized, the Commission will have the authority to enforce those rules against nonbank entities under its jurisdiction. As with its current authority, the Commission intends to use that new authority to the fullest extent possible to protect consumers in the subprime mortgage market. I also anticipate that the FTC would carefully examine whether additional practices are unfair or deceptive and how to address them, including whether to use its current or any new rulemaking authority pursuant to Senator Dorgan's bill, if enacted. The Commission would make this determination in light of the types of practices at issue and balancing the resources needed for both law enforcement and any rulemaking.

Question 2. Section 5 of the Federal Trade Commission Act gives pretty broad authority to the FTC by prohibiting unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce. Section 5 empowers and directs the FTC to prevent persons, partnerships, or corporations from using unfair methods and deceptive acts related to commerce. Certainly, much of the advertising that subprime lenders utilized was clearly deceptive and misleading due to the lack of helpful information disclosed to the consumer. The FTC reauthorization legislation Senator Dorgan introduced earlier this month would require the FTC to conduct an expedited rulemaking on the issue of subprime loans and unfair or deceptive behavior by lenders. Would this provision be helpful to the FTC in preventing some of the questionable practices and advertising that led to the subprime mortgage meltdown?

Answer. As noted above, the Federal Reserve Board appears close to issuing comprehensive new rules under TILA and HOEPA which would apply broadly to subprime loans; many of these rules would apply to all mortgage loans. The proposed rules address underwriting practices, such as lending not based on ability to pay or documented income, as well as a variety of additional acts and practices related to mortgage appraisals, servicing, advertising, and disclosures. If the Board's

[1] *FTC* v. *Associates First Capital Corp.,* No. 01–00606 (N.D. Ga. 2001).

rules are finalized, the Commission will have the authority to enforce those rules against nonbank entities under its jurisdiction. As with its current authority, the Commission intends to use that new authority to the fullest extent possible to protect consumers in the subprime mortgage market.

The Federal Reserve Board's proposal is a comprehensive effort to address a wide range of mortgage lending acts and practices that may cause harm to consumers. Nevertheless, we recognize that inherent in the promulgation of general rules, including the FRB's rules, is the risk that they could prove to be under-inclusive. The FTC therefore would carefully examine whether additional practices are unfair or deceptive and how to address them, including whether to use its current rulemaking procedures or any new streamlined rulemaking procedures permitted under Senator Dorgan's bill, if enacted. The Commission would make this determination in light of the types of practices at issue and balancing the resources needed for both law enforcement and any rulemaking.

Question 3. During the Commerce Committee's FTC reauthorization hearing on April 8, the FTC Commissioners stated that the Commission sent over 200 warning letters to mortgage advertisers and the media outlets that carried their advertisements for home mortgages. These letters stated that the mortgage advertisements identified may be deceptive in violation of Section 5 of the FTC Act or may violate the Truth in Lending Act. Can the Commission provide an update as to how many of the mortgage advertisers corrected their practices and stopped employing deceptive advertising? What action was taken to those lenders that continued their deceptive practices?

Answer. FTC staff recently reviewed current solicitations disseminated by those advertisers who received warning letters in September 2007. Although many have corrected their ads, more than one-third still are disseminating advertising that potentially violates the FTC Act and TILA in a manner identified by the initial warning letters. The potential violations range from noncompliance with technical aspects of TILA to potentially false representations about loan products. We have opened investigations into several of the most egregious violations. In total, the FTC has more than a dozen ongoing nonpublic investigations of home mortgage companies for potential deceptive advertising practices and violations of the Truth in Lending Act ("TILA").

Question 4. Ms. Parnes testimony states that "The FTC's enforcement efforts would be more effective if civil penalties were available against nonbank entities within the FTC jurisdiction who violate the rules." What type of civil penalties would help the FTC increase the effectiveness of its enforcement against non-bank lenders which violate the rules? How would additional civil penalties increase the effectiveness of FTC enforcement over non-bank lenders? What is the reason that the FTC can not use these types of civil penalties against non-bank lenders?

Answer. Under its current authority, the FTC is not authorized to seek civil penalties for violations of TILA and HOEPA. The Commission can seek other types of monetary relief, including consumer redress and other equitable remedies such as disgorgement of ill-gotten gains, from defendants. However, in some cases, restitution or disgorgement may not be appropriate or sufficient remedies, or may be difficult to prove. For example, it may be difficult to determine or quantify the consumer injury or disgorgement amount that would be appropriate to remedy certain advertising or disclosure violations. Civil penalties for violations of the Board's proposed rules would enable the Commission to better achieve the law enforcement goal of deterrence.

The type of civil penalties that would help the FTC increase its effectiveness are those that the Commission can currently obtain for violations of its trade regulation rules under Section 5(m)(1) of the FTC Act, 15 U.S.C. § 45(m)(1). This provision provides a maximum civil penalty of $10,000 per violation per day, as adjusted by inflation to $11,000. This civil penalty could be incorporated by stating in the language of a bill that the FTC has the power to enforce the provisions of TILA and HOEPA in the same manner as if the violation had been a violation of a Commission trade regulation rule.