



UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

**PREPARED STATEMENT OF THE
FEDERAL TRADE COMMISSION**

before the

CALIFORNIA STATE ASSEMBLY COMMITTEE ON BANKING AND FINANCE

on

Predatory Lending Practices in the Home-Equity Lending Market

February 21, 2001

I. INTRODUCTION

I am Ronald G. Isaac, Assistant to the Director of the Federal Trade Commission's Bureau of Consumer Protection.⁽¹⁾ I appreciate the opportunity to appear before you today to discuss the serious problem of abusive lending practices in the subprime lending industry, commonly known as "predatory lending." I will provide an overview of predatory lending practices and problems that are occurring in the growing subprime industry and I will discuss the Commission's recent activities in this area. In addition, I understand that the Committee is interested in the Federal Reserve Board's Regulations Z and C. Last September the Commission provided recommendations to the Board of Governors of the Federal Reserve System (the Board) about addressing problems in the subprime lending market. This testimony is available on the Commission's website at www.ftc.gov. The Commission is reviewing the Board's December 15, 2000 proposed regulatory changes addressing predatory lending, and the Commission will forward to the Committee any additional comments that it makes to the Board on these issues. Now, however, let me briefly speak about the Commission's role in enforcing laws that bear on these problems.

The Commission has wide-ranging responsibilities concerning nearly all segments of the economy, including jurisdiction over most non-bank lenders.⁽²⁾ As part of its mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which broadly prohibits unfair or deceptive acts or practices in or affecting commerce.⁽³⁾ The Commission also enforces a number of laws specifically governing lending practices, including the Truth in Lending Act ("TILA"),⁽⁴⁾ which requires disclosures and establishes certain substantive requirements in connection with consumer credit transactions; the Home Ownership and Equity Protection Act ("HOEPA"),⁽⁵⁾ which, as part of the TILA, provides special protections for consumers in certain non-purchase, high-cost loans secured by their homes; and the Equal Credit Opportunity Act ("ECOA"),⁽⁶⁾ which prohibits discrimination against applicants for credit on the basis of age, race, sex, marital status, or other prohibited factors. In addition to our enforcement duties, the Commission also responds to many requests for information about credit issues and consumer credit laws from consumers, industry officials, state law enforcement agencies, and the media.⁽⁷⁾

equity loans.⁽¹⁰⁾ This is a \$15 billion increase from 1997, when subprime lenders originated \$125 billion in home equity loans.⁽¹¹⁾

At the same time that subprime loans have become a significant and growing part of the home equity market, the composition of companies involved in the subprime market has been evolving. This may be attributable in part to the

mortgage or no mortgage, who is seeking aluminum siding or new windows, may suddenly find herself with a high-cost home equity loan.(30)

based lending. Cooper agreed to pay redress to consumers and to reform the terms of loans that contained the illegal prepayment penalties. Further, for a period of five years, Cooper was enjoined from issuing additional HOEPA loans unless certain conditions were met.⁽³⁹⁾

country. These training sessions were conducted to assist states in exercising their relatively new enforcement authority under HOEPA(49) and to share information about recent trends.

The Commission has implemented an aggressive consumer education program and has published a series of free publications specifically for homeowners and potential home buyers. For example, in 1996, the Commission first produced "High-Rate, High-Fee Loans (Section 32 Mortgages)" to alert homeowners about their rights under HOEPA. In 1998, in conjunction with the filing of the Capital City complaint, the Commission issued two publications to help consumers recognize and avoid home equity scams and abuses: "Avoiding Home Equity Scams" and "Home Equity Loans: Borrowers Beware." In January 1999, the Commission, along with ten other federal agencies, including the Federal Reserve Board, produced "Looking for the BEST Mortgage - Shop, Compare, Negotiate" to help consumers shop for home loans. During National Consumer Protection Week in February 1999, which highlighted credit fraud and abusive lending practices, the Commission distributed more than 500,000 credit-related publications. As part of "Operation Home Inequity" in July 1999, the Commission partnered with AARP to produce "Need a Loan? Think Twice About Using Your Home as Collateral."(50) In fiscal year 2000, the Commission distributed approximately

23. This scenario is known as "bait and switch" because the closing papers differ from the loan package previously discussed with the borrower.

24. See 12 C.F.R. § 226.4(b)(7). Typically, lenders can easily induce borrowers to sign a line in the thick package of complex loan closing papers indicating that the purchase of insurance is voluntary when, in fact, they have little choice if they want to close the loan at that time. Whether credit insurance is in fact required or optional is a factual question. See Federal Reserve Board, Official Staff Commentary to Regulation Z, § 226.4(d)(5).

25. Lenders have incentives to omit required credit insurance premiums from the disclosures of the annual percentage rate and finance charge. First, the appearance of a lower rate may induce the borrower to follow through on the transaction. Second, the lower figure may cause the lender's annual percentage rate to appear to fall below state rate ceilings or HOEPA triggers, which it may in actually exceed.

26. One method of inducing a borrower to refinance is by issuing a balloon note -- particularly one in which the borrower is paying only interest -- where the note comes due in a relatively short period of time. When the note comes due and the borrower owes a substantial lump sum -- sometimes equal to the entire principal of the original loan -- the borrower must again obtain a loan in order to finance the balloon payment that is due at that time.

Courier-Journal, Feb. 16, 1997, at 16 (lender refinanced borrower's loan four times in nine months). Lenders in the consumer finance industry have long relied on refinancing, and sometimes repeated refinancing, as a source of business. See W. Artz & R. Neihengen, Jr., Analysis of Finance Company Ratios in 1994, 78 J. Commercial Lend

32. A borrower also may be tied to a lender if the lender's appraisal intentionally and significantly overvalues the property because the borrower's loan-to-value ratio may be too high for refinancing. This is known as a "bumped appraisal."
33. See *supra* note 18 for a discussion of the Department of Justice's settlement with Long Beach Mortgage.
34. See Brief of the United States As Amicus Curiae, dated March 10, 2000, in *Hargraves v. Capital City Mortgage Corp.*, Civ. Action No. 98-1021 (JHG/AK).
35. Complaint, *F.T.C. v. First Alliance Mortgage Co.*, Docket No. SA CV 00-964 DOC (C.D. Cal. filed October 3, 2000).
36. Sections 226.17-.18 of Regulation Z set forth the requirements for disclosures for closed-end credit, including but not limited to HOEPA loans. Pursuant to those provisions, lenders offering closed-end credit must provide written disclosures before consummation of the transaction that include the following information about the loan: the amount financed, the finance charge, the APR, and the total of payments. 12 C.F.R. § 226.17-.18.
37. The complaint alleged that higher broker fees were charged to African American females than to white males in violation of the ECOA and the Fair Housing Act, 42 U.S.C. §§ 3601-3619, and that few or no services were performed in exchange for certain broker charges in violation of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2607. See *United States v. Delta Funding Corp. and Delta Financial Corp.*, Civ. Action No. 00 1872 (E.D.N.Y. April 2000).
38. See Federal Trade Commission, *Home Equity Lenders Settle Charges That They Engaged in Abusive Lending Practices; Over Half Million Dollars To Be Returned to Consumers*, Press Release, July 29, 1999.
39. See Consent Judgment and Order, *F.T.C. v. Barry Cooper Properties*, No. 99-07782 WDK (Ex) (C.D. Cal. July 30, 1999). The order provides that Cooper cannot offer or extend any HOEPA loans for the prescribed period of time unless he first obtains a \$150,000 performance bond.
40. See *supra* note 38.
41. See Federal Trade Commission, *Sub-prime Lender Agrees to Settle FTC Charges of Violating Federal Lending and Consumer Protection Laws*, Press Release, July 18, 2000.
42. See *F.T.C. v. Fleet Fin., Inc.*, C3899 (F.T.C. Oct. 5, 1999).
43. See Complaint, *Capital City Mortgage*, *supra* note 14.
44. See 15 U.S.C. § 1692.
45. See *The Money Tree*, 123 F.T.C. 1187 (1997).
46. See *Tower Loan of Miss.*, 115 F.T.C. 140 (1992).
47. See, e.g., *Matter of Commercial Credit Co.*, 82 F.T.C. 1841 (1973), order reopened and modified, 98 F.T.C. 783 (1981).
48. See Federal Trade Commission, *Sub-prime Lender Agrees to Pay \$350,000 Civil Penalty to Settle Charges of Violating Federal Lending Laws*, Press Release, Aug. 24, 2000.
49. State Attorneys General also have authority to enforce HOEPA. See 15 U.S.C. § 1640 (e).

50. Additional housing-related brochures issued by the Commission include: After a Disaster: Hiring a Contractor; Reverse Mortgages: Cashing in on Home Ownership; and Home Equity Loans: The Three Day Cancellation Rule.