SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE AND TOURISM

HEARING ON

IMPROVING CONSUMER PROTECTIONS IN SUBPRIME LENDING

Tuesday, April 29, 2008

WRITTEN TESTIMONY OF BILL HIMPLER

EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS

THE AMERICAN FINANCIAL SERVICES ASSOCIATION

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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 five years.

Fourteen HOPE NOW servicers, responsible for more than 33.3 millions 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% 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 two 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 t*he Mortgage Reform and Anti-Predatory Lending Act of* 2007, HR 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.

<u>FTC Reauthorization Act of 2008</u>

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.

<u>Section 3. Independent Litigation Authority</u>

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.

<u>Section 7. Liability for Aiding and Abetting</u>

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.

<u>Section 8. Permissive Administrative Procedure for Consumer Protection Rules</u>

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 non-traditional 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.

<u>Borrower Contact with Lenders</u>

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 government agencies and consumer counselors to provide mortgage security to at-risk borrowers, and our members' perspective on policy recommendations currently before Congress.