Testimony of

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"Consumer Credit and Debt: The Role of the Federal Trade Commission"

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… ''even though you can't see or hear them at all, a person's a person, no matter how small'' Horton Hears a Who, Dr Seuss, (1954).

I. Introduction

Chairman Rush, Vice Chair Schakowsky, Ranking Member Radanovich, members of the Subcommittee: Thank you for inviting me today to share with you my perspective – and long history with state attorneys general – on the record and role of the Federal Trade Commission (FTC) in relation to consumer credit and debt. This is a particularly welcome discussion, as the credit market was the first domino to fall in the run-up to today's economic crisis.

The short answer to our current situation is that there is – and has for a long while been – insufficient attention paid to meaningful consumer protection, especially at the federal level. In many ways, this is the story of the different roads that the states and the federal government took some time ago. I would like to take this opportunity to fill in that background because it offers lessons for the directions we should take now. Perhaps the most important lesson is that Washington regulators – the FTC and the rest – have a great deal to learn from the states.

We were asked to answer four questions in this hearing:

1. What has been the FTC's record on credit matters?
2. What could it do without increased authority?
3. What could it do without increased authority, but with more resources?
4. What more could it do with more authority?

I will offer some specific ideas about those questions (Section IV), but first I want to put the FTC's current record into historical context. The effectiveness of any regulatory system depends not only on the regulations and the resources, but on the culture of the regulatory institution. There are serious concerns in the case of the FTC and its role as consumer protection watchdog in the area of consumer credit in all three of those areas. But to understand why, it is necessary to understand that historical context.

II. Enforcement

A. Framework

The current crisis of consumer protection in the area of credit and debt did not start last year.

There is a history.

In the summer that I was 22 years old, I walked into my local savings bank to try to get a loan to purchase a 200 year old farmhouse on a Maine country road. Its cost was $9,500. I had borrowed $500 from my younger brother, who was in high school, as a down payment. I was working as a janitor but was going to start teaching junior high school and coaching basketball.

The loan officer sat me down and told me about things I'd never heard – closing costs, title searches, home insurance – and he led me through a maze of forms. I went out and borrowed another $350 from a college friend, signed the forms without reading them and moved my family into the house. It was all mine.

I never had a single doubt about what I did because I knew the loan officer and I knew the bank vice president. He went to my church and his son, Danny, was a friend of my brother and his daughter, Mary, was a friend of mine. He would never have cheated me.

At that time, traditional legal protection for borrowers existed because of state usury laws, state banking commissions, state common law, and state attorneys general, but the real protection came from the culture of trust the comes from personally knowing with whom you are borrowing. The mutual benefits of honest dealing with credit generally and mortgages in particular were clear to entire communities, and therefore to me. We have all seen "It's A Wonderful Life."

Those days are long gone and they were not good for everyone. Entire communities were excluded from credit availability because of race or gender.[1] And today we often do substantial consumer transactions with people we do not know or ever meet.

Economists and lenders accurately point out that the impersonal nature of the transaction significantly reduces transaction costs, lowers the cost of credit and therefore makes credit more widely available. Economists and lenders will never accurately point out that

[1] Keith N. Hylton and Vincent D. Rougeau, *Lending Discrimination: Economic Theory, Econometric Evidence, and the Community Reinvestment Act*, 85 GEO. L.J. 237, 241 (1996).

the impersonalization is accompanied with a terrible increase in the risk of fraud.[2] To the economist and lender, it is an acceptable trade-off.

To our neighbors and friends, and now to the economy as a whole, it is a disaster.

The impersonalization, therefore, reduces trust even as it increases credit. It also increases the need for regulation. And that is what has brought us together this morning.

As we all assumed more debt over the last thirty years, our access to cheaper credit expanded our economic choices.[3,4] Government regulation was unable to keep up with the changes and the safety of the financial products became increasingly suspect.

Honest players in the credit market found themselves undercut by the less responsible. Many either left the market or joined the race to the bottom. Securitization of the debt took credit products further away from those directly engaged with consumers. Bundled credit products became vehicles for immense short term profits to each stakeholder along the line.[5] Credit sellers thus had enormous incentive to exploit, free of regulation and oversight, consumers' lack of information and their inability to understand these complex products. Credit products become more dangerous. Incentives for fraud proliferated.[6]

The legal theories underlying the extension of credit are those of contract law, and as we all know, Americans fundamentally believe in the freedom of contract. Thoughtful legal theorists and economists, however, have long known that the benefits of the extension of credit in a society can only be realized when consumers are rational and informed. If there is no information or if the information is misleading, or false, or if it is in a

[2] Testimony of Tom Miller, Attorney General of Iowa before the U.S. House of Representatives Committee on Financial Services, *Progress in Preventing Foreclosures*, Nov. 2, 2007, p. 4. (Available at http://financialservices.house.gov/hearing110/htmiller110207.pdf). "Securitization separated the origination of a loan from its consequences by dramatically changing the distribution of risk and incentives for mortgage market participants. This has unfortunately led to weak underwriting and in some instances fraud, and to borrowers being placed in loans they could not afford."

[3] Eric S. Rosengren, President & Chief Executive Officer Federal Reserve Bank of Boston, *Subprime Mortgage Problems: Research, Opportunities, and Policy Considerations*, Speech at The Massachusetts Institute for a New Commonwealth, December 3, 2007, p.2. (Available at http://www.bos.frb.org/news/speeches/rosengren/2007/120307.pdf).

[4] For credit expansion over past 10 years see: Joint Economic Committee United States Congress, *The U.S. Housing Bubble and the Global Financial Crisis: Housing and Housing-Related Finance*, May 2008. (Available at http://www.house.gov/jec/news/Housing%20Bubble%20study.pdf). For expansion of credit over the past 30 years, see Patricia A. McCoy, Andrey D. Pavlov & Susan M. Wachter, *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, forthcoming Conn. L. Rev. (2009).

[5] Adam B. Ashcraft and Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit,* Federal Reserve Bank of New York Staff Reports, no. 318, March 2008 (Available at http://www.newyorkfed.org/research/staff_reports/sr318.pdf).

[6] Testimony of Tom Miller, Attorney General of Iowa before the U.S. House of Representatives Committee on Financial Services, *Progress in Preventing Foreclosures*, Nov. 2, 2007, p. 4. (Available at http://financialservices.house.gov/hearing110/htmiller110207.pdf).

language that cannot be understood or can be changed by the lender at any time, then the promised benefit of credit expansion will not occur.[7]

B. Federal Approach

Over many years, the Congress has passed a series of laws designed to prohibit specific fraudulent, unfair or deceptive practices – the Fair Debt Collection Practices Act,[8] Equal Credit Opportunity Act,[9] the Home Ownership and Equity Protection Act (HOEPA),[10] or to foster informed decision making – the Truth in Lending Act,[11] or to assure accuracy in the credit reporting system – the Fair Credit Reporting Act.[12]

These laws are enforced by federal banking agencies who are in a position to monitor lenders on an on-going basis through routine monitoring and examinations.[13] Because their prime responsibilities are to ensure the safety and soundness of lending institutions, consumer protection will never be the highest priority.[14]

The Federal Trade Commission, by contrast, does not have monitoring and examination authority over depository institutions. Like state attorneys general, with whom it shares enforcement authority over non-depository lenders, it operates under a law enforcement model. That means it acts only after a problem has already gotten big enough to attract notice.

A hands-off regulatory approach and a series of narrowly targeted laws led the industry to act as if they could do anything that was not specifically prohibited. This approach by the federal government allowed credit products to become more dangerous to consumers.[15,16]

[7] 15 USCS § 1601 "The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this title [15 USCS §§ 1601 et seq.] to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices."
Resolution Trust Corp. v. Martinez, 1994 U.S. Dist. LEXIS 21506 (S.D. Ohio Aug. 24, 1994) "The Truth in Lending Act (TILA), 15 U.S.C. § 1601 et seq., is designed to ensure that consumers can make informed, rational choices regarding the credit transactions into which they enter."

[8] 15 U.S.C. § 1692 (1978).

[9] 15 U.S.C. § 1691 (1974).

[10] 15 U.S.C. § 1639 (1994)

[11] 15 U.S.C. § 1601 (1968).

[12] 15 U.S.C. § 1681 (1970).

[13] Christopher L. Peterson. *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda.* 78 Temp. L. Rev. 1, 73 "The primary mission and long-standing cultural focus of federal depository institution regulators has been monitoring the safety and soundness of their institutions, rather than consumer protection."

[14] Eric Nalder, *Mortgage System Crumbled While Regulators Jousted*, The Seattle Post-Intelligencer, October 11, 2008, (hereinafter "Nalder"). (Available at http://seattlepi.nwsource.com/business/382860_mortgagecrisis11.html).

[15] In an amicus brief written by North Carolina Attorney General Roy Cooper (and signed by 49 states), Cooper notes: "By contrast, the OCC's record of enforcing consumer protection laws against national banks has been described as "relatively lax" and "unimpressive," particularly when compared to the more

The federal laws allowed lending contracts to become more complex and, in the case of credit cards, even to be changed retroactively.[17]

This has made it impossible for consumers to understand their credit documents, which is necessary for self-protection and for rational comparison of competitive credit products. In fact, in both the area of credit cards and mortgages, the Federal Reserve Board has recently admitted that some practices and terms are so complicated that they simply defy comprehensible explanation.

Ironically, providing more and more complex information in impossible to understand language results in consumers becoming less informed about the financial products they are purchasing. The complexity is known to every marketer of consumer products and the result is a confused and manipulated consuming public, and an atmosphere conducive to fraud.[18]

Over the last ten years, the federal regulatory approach has increasingly reflected a deregulatory philosophy. The federal government began to restrict existing governmental resources to root out fraud by cutting back enforcement on the federal level just as it expanded its efforts to preempt enforcement at the state level.[19]

vigorous enforcement efforts of state authorities. Christopher L. Peterson, Federalism and Predatory Lending: Unmasking the Deregulatory Agenda, 78 TEMP. L. REV. 1, 70-74, 77-81 (2005) (hereinafter "Peterson, Unmasking the Deregulatory Agenda"). As subprime mortgage lending abuses became epidemic, the OCC and other banking regulators were criticized for their slow response. See Edmund L. Andrews, Fed Shrugged as Subprime Crisis Spread, N.Y. TIMES, Dec. 18, 2007, at 1; Greg Ip & Damian Paletta, Lending Oversight: Regulators Scrutinized in Mortgage Meltdown – States, Federal Agencies Clashed on Subprimes as Market Ballooned, WALL ST. J., Mar. 22, 2007, at A1. Former Federal Reserve Chairman Alan Greenspan has acknowledged that federal regulators lack the skills and resources to effectively police the lending industry for unlawful practices. He also observed that the primary law enforcement role in this area should be with state attorneys general. Jane Wardell, Greenspan Defends Subprime Market, ASSOCIATED PRESS, Oct. 3, 2007, available at www.washingtonpost.com/wp-dyn/content/article/2007/10/02/AR2007100200784.html."
(Available at http://projects.newsobserver.com/sites/projects.newsobserver.com/files/cooper-amicus.pdf).

[16] Prepared Statement of Patricia A. McCoy, *Hearing on "Consumer Protections in Financial Services: Past Problems, Future Solutions" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs*, March 3, 2009, at 11-24.

[17] Julia Lane, *Will Credit Cardholders Default over Minimum Payment Hikes?* 18 Loy. Consumer L. Rev. 331, 348 "Credit card issuers typically reserve the right to change the terms of each card for any reason, allowing them to apply higher default rates to balances that existed before the event that triggered the default rate even occurred. … Because the credit card company has reserved the right to change the terms at anytime, it is not required to notify the cardholder of the retroactive rate. The credit cardholder is left confused, with little recourse, because the OCC has upheld the practice so long as the credit card companies are not intentionally deceiving their customers."

[18] Adam B. Ashcraft and Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit,* Federal Reserve Bank of New York Staff Reports, no. 318, March 2008, p.11. (Available at http://www.newyorkfed.org/research/staff_reports/sr318.pdf). "[M]any products offered to sub-prime borrowers are very complex and subject to mis-understanding and/or mis-representation."

[19] Robert Berner and Brian Grow, *They Warned Us: the Watchdogs Who Saw the Subprime Disaster Coming - and How They Were Thwarted by the Banks and Washington*, Business Week, October 20, 2008

The federal deference to the myth of a self-correcting market and faith in deregulation were not an accident. They reflected the deliberate policy of the Administration and of many in the Congress. So long as the beneficiaries of the laissez faire regulatory approach continued to provide easy credit to consumers and supersized returns to investors, and so long as home prices and the Dow Jones continued to rise, the public did not complain about the loosening of the regulatory reins.

In the then prevailing political climate, the federal government did little or nothing to engage in preventive consumer protection, or to set a basic floor for fair business conduct. Instead it talked about setting the standards after the fact through "case by case" law enforcement, but rarely followed up. So with no standards up front, and little enforcement on the back end, industry-wide standards of business conduct fell.

C. State Approach

The states followed a different regulatory path. In the 1970s and 1980s, each state passed Unfair and Deceptive Acts or Practices (UDAPs) that were based on a uniform model and allowed state attorneys general, and in most states private litigants, to move against any business practice that they considered to be unfair and deceptive. These laws were analogous to the Federal Trade Practices Act, but did not include many of the federal exemptions. A clear majority allowed state attorneys general to proceed against depository institutions.[20] Until recent federal banking regulatory initiatives state attorneys general had broad, unfragmented jurisdiction. As a result, when credit card banks or mortgage servicing banks teamed up with unscrupulous direct marketers, they could act against both auto dealers and the auto loan lenders to stop unfair and deceptive practices in auto financing.

State attorneys general saw the need for consumer protection in the area of credit.

They got it first.

And they got it right.

The attorneys general got it first and got it right not because of attorney general leadership – although there was a great deal from both the attorneys general and their staffs on a bi-partisan basis – but because they are structured to respond quickly and effectively.

Attorneys general are able to put together working groups and investigate immediately shortly after receiving complaints. As elected officials, they have a public forum which they can use to get results quickly – results that often have national implications.

[20] 15 U.S.C. § 41-58 (2006).

D. Contrast Between State and Federal Approaches

During the late 1970s cooperation between the attorneys general and the Federal Trade Commission was extraordinarily high.[21] The FTC and the attorneys general worked on the same side of the table. The FTC urged states to pass strong consumer protection statutes and engaged in training and litigation support to empower state consumer protection. The capacity of state attorneys general to fight consumer fraud was made possible by direct federal funding through the Law Enforcement Assistant Agency (LEAA).

This cooperation disappeared overnight with the election of President Reagan. This led to the appointment of David Stockman as head of the OMB, who attempted to impound federal monies already sent to state attorneys general, and James Miller as head of the FTC, who not only stifled the FTC, but regularly tried to prevent the states from filling the void in consumer and antitrust.[22]

The lack of cooperation was overt. FTC Chair Miller would join us at meetings of the National Association of Attorneys General and attack our efforts at consumer protection. He was hostile to the attorneys general and we were hostile right back. Under Miller's leadership, the FTC would regularly appear in opposition to consumer protection initiatives by state attorneys general.

Positive cooperation between the attorneys general and the FTC was reestablished with the appointment of Janet Steiger to the Chair of the FTC by President George H.W. Bush. Her successor, Robert Pitofsky, who was appointed by President Clinton, continued cooperation with the attorneys general.

This cooperation consisted of a formal Executive Working Group (EWG) wherein the FTC, the U.S. Department of Justice, and state attorneys general would meet and consult

[21] Benjamin S. Sharp, Deputy Director, Bureau of Competition, Federal Trade Commission, *Innovative Relief and Class Action Issues in Government and Private Actions: FTC Antitrust Remedies: In the Classic Tradition*. 50 Antitrust L.J. 83 "The parens patriae law has spawned a growing number of lawsuits brought by state attorneys general to recover damages on behalf of citizens of their states as a result of overcharges by antitrust violators. Several FTC actions have been followed by such state suits. In the *Levi Strauss* litigation, which was sparked by an FTC consent order against the jeans maker's resale price maintenance policy, ten state suits have produced a total settlement of almost thirteen million dollars. In the *Binney & Smith* matter, which involved a Commission investigation of horizontal price fixing by several art supply firms, eleven states have filed suit. The Commission has a policy of full cooperation with state attorneys general in disclosing its evidentiary files. This policy has been upheld by federal courts as within the Commission's discretion."

[22] Roger Slade, *The Second Circuit Review -- 1984-1985 Term: Antitrust: Federal Obstruction of State Antitrust Enforcement: The Second Circuit Finds no Place For State Participation in the Fast World of Mergers*. 52 Brooklyn L. Rev. 591, 593 "State efforts to increase their antitrust enforcement presence suffered a serious setback … in *Lieberman v. FTC.* The litigation was prompted by the FTC's revised interpretation of state law enforcement's role in the premerger review process. In contrast to the Commission's well-established policy of sharing premerger information with state governments, the FTC suddenly began to deny requests made by state attorneys general to inspect premerger information."

on priorities, policy and cases. It also consisted of daily communication between FTC staff and state Assistant Attorneys General working on specific cases.

There was again the presumption that the FTC and the attorneys general would be on the same side.

III. History of State and FTC Enforcement

A. FTC Cases: Associates

In 2001, after several years of investigation, the FTC took significant action against one of the top subprime lenders. The Associates First Capital Corporation and Associates Corporation of North America ("Associates") had a long and notorious record of predatory lending violations and the matter was settled by the FTC in the Fall of 2002 for the largest amount ever received by the Commission in a consumer protection matter. (Associates was purchased by Citigroup during the investigation.) Initially, the FTC's case took aim at what was a fundamentally unfair business model to lure people into a trap of high cost loans, and then made it very hard for them to walk away. The settlement by the FTC focused on just one aspect of it: insurance packing. The $215 million was distributed according to the FTC to "as many as two million consumers." Citigroup made significant changes in the practices that had been followed by Associates.

While successful, the 2002 settlement was the last case against a significant national mortgage originator handled by the FTC.[23]

B. Attorneys General Cases: Household, Ameriquest, Countrywide

Household International

Almost simultaneously with the FTC's Associates action, the other top subprime originator of the time, Household International, was the focus of a joint investigation by state attorneys general and state financial institutions regulators. [24]

The investigation and settlement effort was led by Attorneys General Tom Miller (Iowa), Roy Cooper (North Carolina), Christine Gregoire (Washington), and New York State Banking Superintendent Elizabeth McCaul**,** along with staff from several other states. Ultimately, all 50 states joined. The case, settled on October 11, 2002, was according to Miller, "the largest direct restitution amount ever in a state or federal consumer case," [25]

[23] Since then, the FTC has taken positive action against national players. See Fairbanks in 2003 (http://www.ftc.gov/opa/2003/11/fairbanks.shtm) and EMC in 2008 (http://www.ftc.gov/opa/2008/09/emc.shtm)

[24] For a general description multistate litigation see: Jason Lynch, *Federalism, Separation of Powers, and the Role of State Attorneys General in Multistate Litigation*, 101 Colum. L. Rev. 1998 (2001).

[25] *States Settle With Household Finance: Up to $484 Million for Consumers*. Iowa Office of the Attorney General Press Release, October 11, 2002. (Available at http://www.iowa.gov/government/ag/protecting_consumers/2002_news/10_11_2002.html).

bringing nearly half a billion dollars ($484 million) in financial relief to Household borrowers.
The settlement also provided significant injunctive relief, limiting front points, origination fees, prepayment penalties, and "piggyback" second mortgages, and requiring additional loan disclosure.

A review of the Household case reveals a state-based philosophy that is different from that of the federal government. The settlement prohibitions are grounded in basic consumer law rather than in violations of technical federal or state banking regulations.

Household showed that attorneys general are able to initiate cases in the area of credit fraud because they operate under flexible state UDAP statutes.

Ameriquest

While the1998-2002 subprime market leaders Associates and Household were defending federal and state law enforcement actions, a different kind of subprime lender business model moved rapidly up to number one market share in 2003-2005: Ameriquest.

Ameriquest became by far the leading and most prominent subprime lender with twice the assets of its next competitor.[26]

The attorneys general were not deterred by industry and federal government accusations of being activist. They were not deterred by the intense lobbying by the defendant and trade associations to which it belonged.

Ameriquest settled with a bi-partisan group of attorneys general for $325 million and for a host of changes to their fraudulent lending practices, including wholesale misrepresentation of contracts, negotiating technical lending documents with Hispanic lenders who could not speak or read English, and making secret deals with allegedly “independent” appraisers who would over inflate or simply misrepresent real estate values to subprime borrowers. [27]

Again, the case was investigated and settled by the attorneys general and state banking regulators. Again reforms were achieved. Again the federal agencies were silent.

Although the largest subprime lender signed an extraordinary settlement document and disappeared from the marketplace, it was clear to the attorneys general that official Washington simply did not want to blow the whistle on the fraudulent lending practices that were sweeping the country.

With the top market share of subprime originators for every year between 1998 and 2005 having been found to have engaged in large-scale unfair and deceptive acts and practices,

[26] Mike Hudson and E. Scott Reckard, *Workers Say Lender Ran ‘Boiler Rooms*,’ Los Angeles Times.
[27] Ibid., Alex Veiga, Attorneys General Hail $325 Million Settlement With Ameriquest, Jan. 26, 2006, Associated Press.

either by the FTC (Associates) or the states (more on Associates, Household, Ameriquest) it would have been logical for Washington to be asking questions about this industry. But the industry continued to either pass these actions off as aberrations or to attribute the actions to overzealousness by the states, rather than looking in the mirror. Instead, they warned Washington that this attitude would "impede access to credit" and take away the American dream. Congress took no legislative action.[28] However, the Senate did take action when it confirmed the sole owner of Ameriquest to be our Ambassador to the Netherlands. [29]

The state attorneys general continued to work on these issues. They formed the State Foreclosure Prevention Working Group and publicly predicted the potential of a million foreclosures. The Group continues to meet and explore settlements and mediations with servicers and other stakeholders.[30] Most attorneys general are now fully engaged in consumer education, and in litigation concerning credit fraud violators that fall within their jurisdiction.

Countrywide Financial Corporation

Just last year, the cycle repeated again when state attorneys general investigated and settled with the Countrywide Financial Corporation. [31]

In 2007, Countrywide had become the largest prime and subprime mortgage lender in the country. Attorneys general around the country began to receive numerous complaints as to Countrywide's lending practices. When it appeared that Countrywide's sale to the Bank of America was about to close and allow Countrywide to escape state jurisdiction as the result of the OCC's preemption initiative, the California and Illinois Attorney General's Offices filed suit alleging that Countrywide had "engaged in a wide range of deceptive practices" and "originated loans with little or no regard to borrowers." [32] These practices included inappropriate loosening of underwriting standards, insufficiently disclosed "teaser" interest rates as low as 1% and a host of highly complex loan products inappropriate for homeowners.

[28] Former Rep. Sue Kelly (R-NY) convened a hearing on January 28, 2004 and asked for the OCC to delay implementation of the OCC's preemptive rules pending a full Congressional review. Her request was denied by the Comptroller of the Currency. Congressional Review of OCC Preemption: Hearing Before The Subcommittee on Oversight and Investigations of the H. Comm. on Financial Services, 108th Cong. (2004). But see: Remarks of Cong. Oxley (R- Ohio): "the OCC regulations represent a thoughtful attempt to codify and harmonize past legal precedents, and there are many, and regulatory guidance into a coherent framework for resolving conflicts between federal and state laws as they apply to national banks."

[29] Jonathan Peterson, *Senate Confirms Ameriquest Founder as Ambassador*, February 10, 2006, Los Angeles Times.

[30] *States' Foreclosure Prevention Working Group Produces First Report on Mortgage Servicers' Loss-Mitigation Performance*. Iowa Office of the Attorney General Press Release, April 22, 2008. (Available at http://www.iowa.gov/government/ag/latest_news/releases/feb_2008/Foreclosure_prevention.html).

[31] *Miller: AGs Reach Agreement with Countrywide Financial that Will Help Almost 400,000 Borrowers Facing Foreclosure.* Iowa Office of the Attorney General Press Release, October 6, 2008. (Available at http://www.iowa.gov/government/ag/latest_news/releases/oct_2008/Countrywide.html).

[32] Testimony of Illinois Attorney General Lisa Madigan, House Committee on Financial Services, March 20, 2009, p.3.

Iowa Attorney General Tom Miller, the lead counsel in both the Household and Ameriquest settlements, once again convened a multistate negotiating team that worked with the California Attorney General Jerry Brown and Illinois Attorneys General Lisa Madigan that and resulted in a global settlement. Announced on October 6, 2008, Countrywide (now owned by Bank of America) agreed to commit an extraordinary $8.7 billion in direct loan relief, which will cover approximately 400,000 borrowers. In addition, Countrywide will give $150 million to a foreclosure relief fund that will help borrowers facing late payments and foreclosures.

Unlike the Household and Ameriquest settlements, the Countrywide settlement did not focus on banning particular lending practices, which were by 2008 arguably preempted, and instead focused on mortgage modification programs, including the waiver of fees, to allow owners to stay in the homes.

C. Lessons Learned

Attorneys general have consumer protection divisions that gather consumer complaints on a daily basis. While the 5 federal agencies also collect consumer complaints, there are 51 state attorneys general. Attorneys general and their staffs operate in a bipartisan manner and their staffs talk to each other. Attorneys general and assistant attorneys general have phone numbers that are listed.[33] They live in impacted communities. They see the problems sooner, and they see the consequences sooner. Their neighbors and the relatives of their neighbors are the ones affected.

It is the structure of the state attorneys general that led to Household. When the problems with Household began, consumer fraud phone lines lit up in attorney general offices and advocates, such as AARP, walked in the door. Attorneys general reached out to their state regulators who joined the working group. When companies such as Household lied in their defense – the usual "rogue office" defense for example – state attorneys general were able to quickly uncover the lies and strike a settlement.[34]

Now it is clear to everyone that consumer protection is not a drag on the credit business. It is vital to the health of that business, and to the health of the economy. We hope that Congress will keep in mind that those closest to the impact may have the best view. For Congress, that means that baseline consumer protection should be just that – baselines. Misguided efforts for broad preemption cannot be allowed to stop states from dealing with problems when they arise.

[33] Attorneys general and their staff regularly participate in training under the auspices of the National Attorneys General Training and Research Institute (NAGTRI) and the National State Attorney General Program at Columbia Law School. http://www.stateag.org

[34] Sally Peacock, *How the Household Settlement Uncorked a Law Enforcement Bottleneck*, December 2002. (Available at http://www.law.columbia.edu/center_program/ag/Library/studentpapers).

Federal agencies, supported by the banks who fund them, and who opposed state scrutiny, continue to litigate in the courts to preempt invaluable state consumer protection.

The attorneys general are continuing to fight a two-front battle to protect consumers. On the one hand, they are litigating against the perpetrators of fraud.[35,36] On the other hand, they are battling federal agencies all the way to the U.S. Supreme Court to maintain their traditional jurisdiction over federally chartered lending institutions. Next month, in Cuomo v. Clearinghouse, the U.S. Supreme Court will again hear arguments on the extent of state jurisdiction this time over their ability to investigate racial bias in lending.[37] Yet again, the attorneys general are battling the federal government and the lending industry.

IV. Four Questions

The issues at today's hearing are four:

1. What has been the record of the FTC on credit matters?

The Federal Trade Commission possesses an extraordinarily broad mandate in the area of consumer protection even as it has been forced to operate with decreased resources. The FTC is further hampered by limited jurisdiction when addressing credit issues arising from depositary lenders.

Although there has been some increase in staff allocation to credit matters in the last few years, the truth is that the number of bodies available to this issue within the FTC is miniscule when compared to the seriousness of the problem. It is for this reason that I applaud the Committee for convening this hearing. Clearly the FTC needs support in its effort to protect consumers if it is to take a leadership position on credit fraud.

That being said, I do believe that the FTC could have done more with what it has. For instance, after the Associates settlement in 2002, the FTC brought no new major enforcement actions for abusive mortgage origination during the remainder of the housing bubble.[38] Instead, it simply called on consumers to "educate themselves" despite rampant fraud and hopelessly outdated disclosures.

[35] Testimony of Illinois Attorney General Lisa Madigan, House Committee on Financial Services, March 20, 2009, p. 5-6. See also: *Commonwealth v. Fremont Inv. and Loan*, 897 N.E. 2d 733 (Mass. 2008)

[36] Testimony of Sarah Raskin, Maryland Commissioner of Financial Regulation before the U.S. House of Representatives Committee on Financial Services, *Federal and State Enforcement of Financial Consumer and Investor Protection Laws,* March 20, 2009.

[37] *Cuomo v. Clearing House Association* (2009).

[38] See FTC Subprime Lending Cases (Since 1998), available at http://www.ftc.gov/opa/2002/07/subprimelendingcases.shtm. The only major subprime lending case initiated by the FTC since 2002 was against Fairbanks Capital Corporation, for servicing abuses.

Similarly, the leadership of the FTC, especially during the critical years of 2002 to 2007, never sat down with those who were at the forefront of battling credit fraud in order to establish enforcement priorities. The FTC leadership did not meet with attorneys general, state banking regulators and other advocates to learn from them and to set a coordinated strategy. In the aftermath of the Household, Ameriquest and Countrywide settlements, the FTC never reached out to the attorneys general or their staffs to share the lessons of the experience.

Attorneys general and their staffs repeatedly have told me that they cannot understand why the Executive Working Group (EWG), which consisted of the FTC, the U. S. Department of Justice and the attorneys general, no longer meets. They cannot understand why traditional federal state training has been reduced.

The fact is that the previous leadership of the FTC isolated themselves from their natural allies – state attorneys general – and no one can understand why.

2. What more could it do without increased authority?

The first step, which appears to already be underway, is for the FTC to shift its resources to financial and credit fraud. The Chair is to be commended for that approach.

The second step is to reestablish the Executive Working Group. Sometimes old ideas are good ones, and a formalized relationship with attorneys general is essential. The leadership of the FTC has to get out of Washington and meet with state leaders.

It would also be advisably for the FTC to meet regularly with consumer advocacy organizations and representatives of the private bar who regularly bring consumer class actions under state consumer laws.

It is therefore my position that before any additional authority over credit is given to the FTC, it should make a commitment to broaden its horizons. It should listen to more people. The majority of the FTC has been drawn from the antitrust bar of large law firms. It is an organization immersed in the culture of the Beltway. Unlike those of you on this committee and every attorney general, the FTC does not have to face constituents or live in impacted communities. The FTC must begin to work with all stakeholders.

On March 3, 2009, Sheila Bair, the FDIC Chairman, stated in a speech before the National Association of Attorneys General (NAAG) that, "if ever there were a time for the states and the feds to work together, that time is right here and now. The last thing we need is to preempt each other."[39]

This clear statement has gone a long way to enhance both communication and cooperation among attorneys general, state regulators and the FDIC. It is very important

[39] Speech before the National State Attorneys General, March 3, 2009, Washington, D.C. http://www.fdic.gov/news/news/speeches/chairman/spmar0309.html

that the Chair of the FTC join the Chair of the FDIC with a public statement so that the specter of preemption can be taken from the table in the FTC's future work with state attorneys general.

3. What more could it do without increased authority but more resources?

The FTC should have more staff, but that will not solve the problem. It should learn to leverage other entities that are on the same side.

In this respect, Congress, too, could recognize that this is an area in which it has been complicit. It is a simple truth is that there will never be enough public resources to address all the abuses in the marketplace. The concept of the private attorneys general – which recognized and allowed consumers the right and ability to vindicate their own legal rights – is vital and has proved highly successful in the states. Too often, the ill-conceived idea that lawyers who represent real people with real rights are simply "greedy lawyers" from whom business must be protected simply makes it easier for those engaging in bad practices in the business sector to escape accountability.

4. What additional could it do with more authority?

At the present time, there is no federal agency that has the necessary mandate to protect consumers in matters of credit. Existing federal agencies are primarily responsible for the safety and soundness of the institutions that they regulate. Consumer protection will never be their first priority. While the FTC is the primary consumer protection agency of the federal government, it clearly lacks the jurisdiction, resources or culture to assume that task without a significant change in policy.

There has been speculation that the FTC will become the new agency to regulate credit issues along the lines of the recently introduced Durbin/Delahunt proposal.[40,41,42] I have no position on that legislation, but I would oppose increasing credit authority to the FTC unless it becomes significantly more integrated with others with similar concerns.

The new rulemaking authority granted to the FTC is a positive step. Consistent with my earlier remarks, it is important that this new authority be used carefully and in conjunction with other stakeholders. This welcome change has wisely freed the FTC from antiquated rulemaking procedures. The FTC is now poised to quickly establish proactive, *ex ante* rulemaking on credit related issues. I believe that it is vitally important

[40] A recent law article by Elizabeth Warren provides both important analysis and an interesting proposal on reforming federal oversight of credit instruments. See: Warren, Elizabeth & Oren Bar-Gill. "Making Credit Safer," 157 *University of Pa. Law Review* 1 (2008).

[41] Prepared statement of Professor Patricia McCoy, University of Connecticut School of Law, hearing on "Consumer Protections in Financial Services: Past Problems, Future Solutions" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs.

[42] Kara Scannell, *Democrats Propose Bill to Create New Financial Products Regulatory Agency,* March 10, 2009. (Available at http://online.wsj.com/article/SB123672634863188481.html?mod=googlenews_wsj)

for the FTC to invite the attorneys general, state banking regulators and other advocates into the rulemaking process. Such a step will significantly improve the likelihood that the attorneys general will enforce those rules in federal court.

V. Conclusion:

As the Director of the National State Attorney General Program at Columbia Law School, I spend virtually all of my time with attorneys general and the men and women who work in their offices. As a participant and observer of state law enforcement for thirty years, I believe that the leadership efforts of state officials in the area of credit fraud contain valuable lessons for us all.

Although still forced to battle federal agencies who are litigating to limit their authority, I continue to believe that a positive federal and state consumer protection partnership is the most effective way to protect our citizens from fraud. I hope that the FTC will take a lead in bringing that partnership to fruition.

I want to close by again thanking the Committee for inviting me to present my views and look forward to responding to your questions.