



Office of the Secretary

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

January 26, 2006

Sandra F. Braunstein, Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Dear Ms. Braunstein:

This letter responds to your request for information regarding the enforcement activities of the Federal Trade Commission ("Commission" or "FTC") under the Truth in Lending, Consumer Leasing, Equal Credit Opportunity, and Electronic Fund Transfer Acts ("Acts") during the 2005 calendar year, for use in preparing the Federal Reserve Board's ("Board") Annual Report to Congress. You have asked for information regarding the Commission's enforcement activities pursuant to those Acts, including methods of enforcement, and the extent to which compliance is achieved by entities subject to the Commission's enforcement authority.¹ Also, you have asked whether the Commission recommends any changes to these laws or their implementing regulations or wishes to provide other comments or observations.

I. THE COMMISSION'S 2005 ENFORCEMENT ACTIVITIES UNDER THE ACTS²

Truth in Lending Act³

In calendar year 2005, the Commission continued its enforcement activities against unlawful subprime lending practices. The Commission entered into three settlements, and pursued two ongoing litigations in federal district court action for alleged violations of the TILA,

¹ The Commission is charged with enforcement of the Federal Trade Commission Act ("FTC Act") and various federal consumer financial laws and regulations, including the Truth in Lending Act ("TILA"), Consumer Leasing Act ("CLA"), Equal Credit Opportunity Act ("ECOA"), and Electronic Fund Transfer Act ("EFTA"), with respect to most nonbank entities in the United States. The Commission does not have data regarding the extent of compliance by those numerous nonbank entities. As a result, this letter does not provide information on that issue.

² Information concerning the Commission's enforcement and other activities discussed in this report is also available at the Commission's Web site at <http://www.ftc.gov>.

³ The Commission's enforcement activities under the TILA in 2005 pertained to credit violations. No enforcement actions alleging violations of the CLA, an amendment to the TILA, were issued.

Regulation Z, and the FTC Act. There are ongoing investigations of potential TILA violations.

A. Mortgage Cases Alleging TILA Violations

The Commission settled charges against the individual defendant that were filed in 2004 in federal district court against Phillip W. Ranney and a group of Colorado-based mortgage brokers operating as PWR Processing, Inc., for alleged violations of the FTC Act and the TILA, among other statutes.⁴ The complaint charged that the defendants promised consumers “no-fee,” low-interest home mortgages following a process of multiple refinances. According to the complaint, the defendants apprised consumers that if they applied for two loans (one at a competitive rate and one at a higher-than-market rate), lenders on the higher-than-market rate loans would pay a premium to the mortgage broker that would be used to pay fees for the lower-interest loan. The complaint alleged that the defendants deceptively claimed that the low-interest loan would then be used to pay off the higher-interest loans, leaving the consumer with a low-interest, “no-fee” loan. The complaint charged that, instead of receiving the promised loan, consumers were left with high-interest loans, often at rates higher than they wanted to refinance. The consent judgment barred Phillip Ranney from making misrepresentations about home mortgage refinancing and from violating the TILA and Regulation Z (including but not limited to the advertising requirements) and required payment of \$128,300 in consumer redress.

The Commission settled charges against Capital City Mortgage Corp. (“Capital City Mortgage”) and various relief defendants for violations of the TILA and Regulation Z and the FTC Act, among other federal statutes.⁵ The complaint alleged that the defendants engaged in unfair or deceptive acts or practices in offering and extending financing and servicing the loans, resulting in many borrowers being overcharged on their loans and forced into default, losing their homes and equity. More specifically, the complaint alleged that defendants included false charges in monthly statements to borrowers, added charges to loan balances, forced consumers to make monthly payments for the entire loan amount while withholding some loan proceeds, foreclosed on borrowers who were in compliance with their loan terms, and failed to release liens on borrowers’ homes after the loans were paid off.

The stipulated order in the Capital City Mortgage case requires defendants to pay \$750,000 in consumer redress and set up a \$350,000 performance fund available if Capital City Mortgage fails to comply with the order. The order also bans Capital City Mortgage from making or servicing any home-secured loan, other than the one loan it is currently servicing. The order also includes other injunctive provisions.

⁴ Federal Trade Commission v. Phillip W. Ranney, No. 04-F-1065 (D. Colo. filed May 26, 2004); Id. (D. Colo. Feb. 22, 2005) (judgment against Phillip W. Ranney). As reported in 2005, a default judgment was awarded in 2004 against the corporate defendants, including PWR Processing and others. The complaint also named Kathleen A. Ranney as a relief defendant; the Commission subsequently dismissed its case against her.

⁵ Federal Trade Commission v. Capital City Mortgage Corp., No. 98CV-237 (D.D.C. filed Jan. 28, 1998); Id. (D.D.C. Feb. 23, 2005) (stipulated order).

The Commission continued its litigation in federal district court against a mortgage broker, Chase Financial Funding, and its principals, for alleged violations of the FTC Act, and the TILA and Regulation Z, in connection with advertisements for extremely low mortgage rates.⁶ According to the complaint, the defendants sent consumers spam and direct mail falsely offering consumers a “3.5% fixed payment” loan, when, in fact, the loans advertised were actually adjustable rate mortgages, where the principal balance would increase if consumers made payments at the advertised rates. The complaint alleged that the defendants violated the FTC Act by deceptively claiming that they offered: 1) a fixed interest rate or fixed payment loan; 2) a loan in which payment of the minimum amount specified covers both interest and principal; 3) a loan with a specific payment schedule, interest rate, and/or APR; and 4) a loan with no prepayment penalty or a penalty that would not apply if the loan was refinanced through the defendant. The complaint also alleged that the defendants misrepresented the “annual cash savings” that consumers would receive if they refinanced through the defendants and that the defendants failed to disclose or to disclose adequately that monthly payment of the specified amount would result in negative amortization, causing an increase in the total debt for periods during the loan. The complaint further alleged that the defendants violated the TILA and Regulation Z by: 1) advertising credit terms other than those that actually are or will be arranged or offered by the creditor; 2) stating a rate of finance charge without clearly and conspicuously disclosing the APR or the fact that the APR may increase after consummation; 3) advertising a “payment rate” without making other required disclosures; and 4) failing to disclose the terms of repayment or the APR, as required. The complaint seeks consumer redress and other permanent equitable relief.

As reported in 2005, the court in the Chase Financial Funding case entered a stipulated preliminary injunction in May, 2004. In 2005, the court held defendant chief executive officer James F. Berry in civil contempt of that order;⁷ he was subsequently arrested under a bench warrant in connection with the contempt order. The court thereafter entered a stipulated order releasing defendant chief executive officer James F. Berry from confinement after his payment of \$275,000 in sanctions and agreement to pay \$400,000 in consumer redress, among other terms.⁸ Litigation continues in the case.

B. Other TILA Cases

The Commission settled charges against Stewart Finance Company, seven related companies, and their principals (collectively, “Stewart Finance”) for alleged violations of the FTC Act and the TILA, among other statutes.⁹ The complaint alleged that Stewart Finance, which

⁶ Federal Trade Commission v. Chase Financial Funding, Inc., No. SACV 04-549 GLT (ANx) (C.D. Cal. filed May 12, 2004).

⁷ Id. (C.D. Cal. July 25, 2005) (civil contempt order imposing sanctions).

⁸ Id. (C.D. Cal. Dec. 7, 2005) (stipulation and order re civil contempt).

⁹ Federal Trade Commission v. Stewart Finance Company Holdings, Inc., Civ. No. 1:03-CV-2648-JTC (N.D. Ga. filed Sept. 4, 2003); Id. (N.D. Ga. Nov. 4, 2005) (stipulated final judgment and order). The companies will liquidate their assets in federal bankruptcy court and through a

provided small personal loans to consumers in the subprime market, engaged in deception and other illegal practices to induce consumers to unknowingly purchase expensive add-on products, such as insurance and car club memberships, to participate in a “free” direct deposit program that was not in fact free, and to incur additional costs and fees by repeatedly refinancing their loans. The complaint also alleged that Stewart Finance failed to include the cost of its ancillary products in the finance charge and annual percentage rate disclosed to consumers.

The stipulated final order in the Stewart Finance case requires the companies to shut down and agree to entry of a \$10.5 million judgment. The order permanently bans the Stewart companies and their principals from participating in any lending or direct deposit business and from offering or selling ancillary products; it also contains other injunctive relief. Under the settlement, the Commission will obtain: 1) a \$10.5 million claim in the consolidated bankruptcy cases of Stewart Finance Company and various related companies and in the bankruptcy case of its now-deceased former chief executive officer, Jon Ben Stewart, Jr.; 2) a fifty percent share of the assets of the district court receivership; 3) a suspended judgment of \$250,000 against relief defendant Janice Stewart; and 4) a judgment of \$423,592.91 against relief defendants William Joseph Stewart and John Benjamin Stewart III.

The Commission continued its litigation in federal district court against National Audit Defense Network, Inc., Tax Coach, Inc. (doing business as Tax Ready), and various officers of both companies.¹⁰ Among other things, the complaint alleged the defendants violated the FTC Act and the TILA and Regulation Z regarding misrepresentations about merchandise refunds and by failing to timely credit consumers’ credit card accounts after accepting the return of tax-information products or otherwise acknowledging that refunds were owed. A trial date has not yet been set.

C. Consumer and Business Education

The Commission’s consumer and business education efforts for consumer credit and consumer leasing are vital to achieving its mission and enforcement goals. In Fall 2005, the Commission unveiled a special Web site for consumers and businesses affected by Hurricanes Katrina and Rita (“Hurricane Recovery Web site”).¹¹ The Web site includes new educational materials on problems and frauds consumers may face. The Web site also provides material on financial issues, including consumer protections under the TILA, such as those against

federal district court receivership. Monies the FTC receives through the bankruptcy and receivership will be added to amounts due from certain individual defendants and directed to a consumer redress fund.

¹⁰ Federal Trade Commission v. National Audit Defense Network, Inc., No. CV-S-02-0131 (D. Nev. filed Jan. 30, 2002). As reported in 2005, the company ceased business operations in 2004, under Chapter 7 of the Bankruptcy Code.

¹¹ See FEDERAL TRADE COMM’N, HURRICANE RECOVERY: INFORMATION AND RESOURCES FOR CONSUMERS AND BUSINESSES, at <http://www.ftc.gov/bcp/conline/events/katrina/index.html>.

unauthorized credit card use, and links to financial resources. In 2005, the Commission also issued updates to various publications relating to the TILA, including "Reverse Mortgages: Get the Facts Before Cashing In On Your Home's Equity" and "Credit and Your Consumer Rights."¹² The Commission also added further Spanish-language publications to the area of its Web site dedicated to providing information and materials to assist Hispanic consumers, including "Payday Loans = Costly Cash."¹³ All of the Commission's consumer protection materials are made available to the public through the Commission's Web site.¹⁴

Equal Credit Opportunity Act

In 2005, the Commission entered into one settlement for alleged violations of the ECOA and Regulation B. There are ongoing investigations of potential ECOA violations.

The Commission settled its action against Capital City Mortgage, discussed above, which alleged, among other things, that the company violated the ECOA and Regulation B by: 1) failing to take written applications for mortgage loans; 2) failing to collect required information about the race or national origin, sex, marital status, and age of applicants; 3) failing to provide rejected applicants with written notice of adverse action; and 4) when providing notice of adverse action, failing to provide applicants with the correct name and address of the Commission, the federal agency that administers compliance with the ECOA for defendants. As part of the settlement, the order prohibits the defendants from violating Regulation B and the ECOA and includes other injunctive relief.

The Commission continued its consumer and business education efforts, including efforts to increase awareness of and compliance with the ECOA. In 2005, the Commission updated its publication "Ready, Set, Credit" to provide additional information to consumers.¹⁵ The Commission's revised publication, "Credit and your Consumer Rights," discussed above, also includes information on consumer rights under the ECOA. The Commission also added information for Hispanic consumers to the Spanish-language area of its Web site, including

¹² See FEDERAL TRADE COMM'N, REVERSE MORTGAGES, at <http://www.ftc.gov/bcp/online/pubs/homes/rms.pdf> and FEDERAL TRADE COMM'N, CREDIT AND YOUR CONSUMER RIGHTS, at <http://www.ftc.gov/bcp/online/pubs/credit/crdright.pdf>.

¹³ See FEDERAL TRADE COMM'N, LOS PRESTAMOS DE DIA DE PAGO LE PUEDEN COSTAR CARO, at <http://www.ftc.gov/bcp/online/spanish/alerts/s-pdayalrt.pdf>. Numerous additional materials for Hispanic consumers are also available. See <http://www.ftc.gov/bcp/online/edcams/ojo/s-index.htm>.

¹⁴ See <http://www.ftc.gov/ftc/consumer.htm>.

¹⁵ See FEDERAL TRADE COMM'N, READY, SET, CREDIT, at <http://www.ftc.gov/bcp/online/pubs/young/readcrdt.pdf>. For other ECOA publications, see <http://www.ftc.gov/ftc/consumer.htm>.

“Mortgage Discrimination” and “Getting Credit.”¹⁶ In addition, the Commission continued its participation in the Interagency Task Force on Fair Lending.

Electronic Fund Transfer Act

Although no enforcement actions were issued in 2005, there are ongoing investigations of potential EFTA violations. In addition, the Commission’s new Hurricane Recovery Web site, discussed above, includes information on consumer protections under the EFTA, such as those against unauthorized debit card use, and links to financial resources. The Commission also issued updates to publications relating to electronic banking, including “Check 21, Substitute Checks, Electronic Processing, and What It Means To You.”¹⁷ The Commission’s revised publication, “Credit and Your Consumer Rights,” discussed above, also includes material on consumer protections under the EFTA.

II. ANY SUGGESTIONS FOR CHANGES IN THE ACTS OR THEIR IMPLEMENTING REGULATIONS

In 2005, the Commission filed a comment supporting the Board’s proposal to revise Regulation E, which implements the EFTA, and its Official Staff Commentary. Among other things, the comment addressed the Board’s proposal regarding: 1) electronic check conversion; 2) clear and conspicuous disclosure and consumer research; and 3) preauthorized electronic fund transfers. The comment is available on the Commission’s Web site.¹⁸

The Commission has no other suggestions for changes in the Acts or their implementing Regulations at this time.

¹⁶ See FEDERAL TRADE COMM’N, DISCRIMINACION CONTRA LOS SOLICITANTES DE HIPOTECAS, at <http://www.ftc.gov/bcp/online/spanish/homes/s-mortgdis.pdf> and FEDERAL TRADE COMM’N, ESTABLECIENDO CREDITO, at <http://www.ftc.gov/bcp/online/edcams/gettingcredit/espanol/index.html>.

¹⁷ See FEDERAL TRADE COMM’N, CHECK 21, SUBSTITUTE CHECKS, ELECTRONIC PROCESSING, AND WHAT IT MEANS TO YOU, at <http://www.ftc/bcp/online/pubs/credit/check21.pdf>. This publication provides information to assist consumers on new electronic issues, including distinguishing substitute checks and other Check 21 issues (which do not involve electronic fund transfers) from electronic check conversion (which involve electronic fund transfers and are covered by the EFTA).

¹⁸ Letter to Jennifer L. Johnson, Secretary, Board of Governors of the Federal Reserve System from Federal Trade Commission by Donald S. Clark, Secretary (Feb. 4, 2005), available at <http://www.ftc.gov/opa/2005/02/fyi0510.htm>. The comment noted the proposal was timely because consumers are increasingly using electronic payment systems to pay for goods and services. According to the comment, because many consumers are not familiar with these payment systems and because of the potential for fraudulent activity involving these systems, clear disclosures and appropriate consumer protections are important.

Sandra F. Braunstein, Director

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The Commission hopes that the information contained in this letter responds to your inquiry and will assist in preparation of the Board's Annual Report to Congress. If any other information would be useful or if you wish to request additional assistance, please contact Peggy Twohig, Associate Director, Division of Financial Practices, at (202) 326-3224.

By direction of the Commission.

A handwritten signature in black ink that reads "Donald S. Clark". The signature is written in a cursive style with a long horizontal line extending from the end of the name.

Donald S. Clark
Secretary