The Federal Trade Commission

Opening Remarks of Michael R. Baye
Director of the Bureau of Economics

Consumer Information and the Mortgage Market Conference
May 29, 2008

Good morning. I'm Michael Baye, the Director of the Bureau of Economics here at the Federal Trade Commission.[1] It is my pleasure to welcome you all to the FTC, and to kick off what promises to be intellectually stimulating day.

Today's economic workshop on information regulation, mortgage choice and mortgage outcomes could not be more timely or important. As you all know, the news is full of reports about how turmoil in housing and mortgage markets affects the financial security and welfare of many hard-working families. The effects can also be felt in our neighborhoods, where vacancies due to foreclosure have increased, and in the overall economy. Earlier this month, *The Wall Street Journal* reported that foreclosure filings for April were up 65% from a year earlier, and that about 2 percent of households nationwide are in foreclosure.[2] Almost daily, there are increased calls for our government

[1] The remarks that follow are my own, and do not necessary reflect the views of the Federal Trade Commission or any of the individual Commissioners. I am grateful to Liz Callison, Jan Pappalardo, Jim Lacko and Paul Pautler for helpful discussions.
[2] "April Foreclosures Hit New High" *Wall Street Journal* (May 14, 2008).

to help consumers and other stakeholders. Multiple pieces of proposed legislation have been introduced in Congress and state legislatures in an attempt to ease the crisis.

Economically sound solutions to these problems require an understanding of why current consumer protection policies may have failed, as well as an assessment of the likely long-run effects of alternative proposed policies on consumer choice and competition in mortgage markets. While there are many ramifications and angles from which to view mortgage markets, this economic conference focuses on how consumer information impacts the functioning of these markets. A variety of distinguished scholars will share their research on how consumer information—and the regulation of such information—effects consumer choices, mortgage outcomes, and consumer welfare. By bringing together distinguished panelists with expertise in real estate economics, mortgage markets, information regulation, as well as marketing and consumer behavior—and through a free and open discussion of the relevant economic issues—I know we will learn a great deal. It is my hope that the fruits of this workshop will be useful to policymakers in their quest to enhance the welfare of consumers.

The Federal Trade Commission's twin missions—consumer protection and competition (or antitrust)—uniquely position staff in the Agency's Bureau of Economics to contribute to today's discussion. It is well-documented in the economics literature that consumer access to accurate information is an essential underpinning of the virtues of competitive markets. For this reason, much of the FTC's work on the consumer protection side uses our expertise in the economics of information to ensure that information disclosed by businesses is accurate, rather than unfair or deceptive, and that the information presented is understood by consumers. This ensures that the freedom of choice that buyers exercise in markets—the hallmark of a free society—is based on the best available information. On the competition side, our expertise in industrial organization permits us to identify anticompetitive business practices, as well as overly burdensome regulations, that distort firms' incentives to engage in healthy price and quality competition. This expertise empowers the Commission to utilize a multi-faceted approach to protecting consumers, especially in the subprime area: We enforce consumer protection laws, provide consumer education, and help ensure that business practices or regulations do not adversely affect competition or consumer choice. In addition, and very importantly, the Commission conducts research to better understand consumer and market behavior in order to ensure that policies designed to protect consumers do exactly that, and that such policies do not have adverse unintended consequences. The Commission also coordinates and shares its expertise in this area with federal banking agencies in connection with their interests in protecting consumers in the mortgage market place. In short, economics as well as history teaches that competitive markets are the best way to protect consumers, and the FTC's twin missions in antitrust and consumer protection work hand in hand to facilitate well-functioning competitive markets.

In light of all this, it is not surprising that mandatory information disclosures play a central role in the existing regulatory framework for protecting consumers in mortgage markets. However, the Commission's experience has demonstrated that current mortgage disclosures are often ineffective in providing consumers with the information needed for a well-functioning mortgage market. These conclusions are drawn not only from numerous law enforcement investigations,[3] but from research by Bureau of Economics economists, including Drs. Jim Lacko and Jan Pappalardo.[4]

We are clearly at an important decision node with respect to public policy, and the stakes are high. Regulations and policy decisions made today will affect consumers' mortgage and home ownership opportunities for years to come. Many stakeholders are involved in this important market; today's scientific discussion of the economic issues and merits of existing and proposed regulations will help us better understand the root cause of the problems as well as the potential benefits and costs of alternative solutions. And regardless of which solution policy-makers ultimately adopt, there are sound economic reasons for improving the flow of information to consumers in mortgage markets.

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[3] In recent years, the agency has brought 22 actions against companies and principals in the mortgage lending industry, involving companies large and small in various regions of the county. *See FTC v. Safe Harbour Found. of Fl., Inc.*, No. 08-1185 (N.D. Ill. 2008); *FTC v. Mortgages Para Hispanos.com Corp.*, No. 06-00019 (E.D. Tex. 2006); *FTC v. Ranney*, No. 04-1065 (D.Colo. 2004); *FTC v. Chase Fin. Funding, Inc.,* No. 04-549 (C.D. Cal. 2004); *United States v. Fairbanks Capital Corp.,* No. 03-12219 (D. Mass. 2003); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *United States v. Mercantile Mortgage Co.,* No. 02-5079 (N.D. Ill. 2002); *FTC v. Associates First Capital Corp.,* No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.,* No. 00-964 (C.D. Cal 2000); *United States v. Action Loan Co.,* No. 00-511 (W.D. Ky. 2000); *FTC v. NuWest, Inc.*, No. 00-1197 (W.D. Wash. 2000); *United States v. Delta Funding Corp.*, No. 00-1872 (E.D.N.Y. 2000); *FTC v. Cooper Props.,* No. 99-07782 (C.D. Cal. 1999); *FTC v. Capitol Mortgage Corp.*, No. 99-580 (D.Utah 1999); *FTC v. CLS Fin. Serv., Inc.*, No. 99-1215 (W.D. Wash. 1999); *FTC v. Granite Mortgage, LLC,* No.990289 (E.D. Ky. 1999); *FTC v. Interstate Res. Corp.*, No. 99-5988 (S.D.N.Y. 1999); *FTC v. LAP Fin. Serv., Inc.*, No. 990496 (W.D. Ky. 1999); *FTC v. Wasatch Credit Corp.,* No. 990579 (D. Utah 1999); *In re FirstPlus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000); *In re Fleet Fin., Inc.*, FTC Docket No. C-3899 (1999); *FTC v. Capital City Mortgage Corp.,* No. 98-00237 (D.D.C. 1998). Several of these cases have resulted in large monetary judgments, collectively returning more than $320 million to consumers.

[4] FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, THE EFFECT OF MORTGAGE BROKER COMPENSATION DISCLOSURES ON CONSUMERS AND COMPETITION: A CONTROLLED EXPERIMENT (2004), a*vailable at* http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf; FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007), a*vailable at* http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf.

Our first session this morning will focus on recent developments in mortgage market products, and provide us with a better understanding of how mortgage products and mortgage markets have evolved. Over the past decade, changes in this market include the rise and prominence of mortgage products like hybrid ARMs, payment option ARMs, interest-only loans, no down payment loans, piggyback loans, no documentation loans, and other loan products of that are the subject of controversy today. Some suggest that this evolution represents an attempt to expand mortgage markets to include previously under-served groups of consumers, thus broadening access to the American dream of home ownership; others suggest it was a scheme by unscrupulous lenders to prey on unsuspecting consumers; and still others that it was a response to secondary market investors pursuing higher rates of return. Similarly, some explain the increased use of prepayment penalties as a reasonable method of controlling loan risk and offering lower rates to borrowers, while others suggest that they are a way of locking misled consumers into predatory loan terms. Scholars on our first panel will help us understand the root causes of the evolution of mortgage markets. This is a crucial step in understanding the source of the current problems, and to crafting economically sound solutions.

Our second session this morning will focus on the information that consumers receive about mortgage products, how well they understand the information, and its impact on consumer choices over loan products and market outcomes. Distinguished researchers on this panel will address a number of fundamental issues, including the mechanism by which consumers are presented mortgage information and how the framing of the information impacts their choices. They will discuss whether information uncertainty influences consumers' choices over loan products and lenders' decisions of what products to offer and at what price; whether consumers understand the terms of their own mortgage transactions; whether current information policy can be improved; and the role of advertising in the mortgage market. In addition, panelists will share views on what the economics of information tells us about the role of information on market outcomes, the likely effects of regulations on mortgage information, and the lessons that behavioral economics research may provide for the analysis of mortgage information policies.

And this is just the morning; after lunch, Chairman Kovacic will introduce our two afternoon sessions. In the first afternoon session, panelists will use their own expertise to provide perspectives on the relationship between mortgage information and current problems faced by consumers in the mortgage market. The final afternoon session is forward-looking, with a discussion of how consumer information policies could be developed to help prevent deception and delinquencies in the mortgage market.

So as you can see, we are in store for a very full, interesting, informative, and intellectually stimulating day. Let me conclude by thanking all of the scholars on the panels for taking time from their busy schedules to help inform the debate on consumer information policy in mortgage markets. I understand that several of our speakers re-arranged their vacation plans to be here. I am grateful for such self-sacrifice, and hope that your choices have not left you too deeply in debt to your families. Finally, I'd like to thank Jan Pappalardo and Jim Lacko for taking the lead in planning and executing this workshop, and Micah Burger, Maria Villaflor, Alethea Fields, Neal Reed, Tammy John, and Matt Eaton for handling the many burdens of logistics.

I’ll now turn this over to Paul Pautler, the Deputy Director of Consumer Protection in the Bureau of Economics, who is the moderator of the first panel. Thank you all for being here, and enjoy your day at the FTC.