

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

Office of the Secretary

December 18, 2002

Dolores S. Smith, Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Dear Ms. Smith:

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 year 2002 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 2002 ENFORCEMENT ACTIVITIES UNDER THE ACTS²

Truth in Lending Act

In calendar year 2002, the Commission continued its enforcement efforts to curb illegal practices of some subprime mortgage lenders, including three settlements, one new complaint, and one ongoing litigation for alleged violations of the TILA, Regulation Z, and the Federal Trade Commission Act ("FTC Act"). Other investigations of potential TILA violations are ongoing.

¹ The Commission is charged with enforcement of the 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 nation. The Commission does not have data regarding the extent of compliance by these numerous nonbank entities with these mandates. 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>."

A. Mortgage Cases Alleging TILA Violations

The Commission settled charges that were filed last year in federal district court against Associates First Capital Corporation and Associates Corporation of North America (collectively, "The Associates"), Citigroup Inc ("Citigroup"), and CitiFinancial Credit Company ("CitiFinancial").³ The complaint charged The Associates with violations of the TILA, Regulation Z, and the FTC Act, as well as other laws. The complaint alleged that The Associates engaged in deceptive practices and other law violations to induce consumers to take out or refinance loans with high rates, costs, and fees and to purchase high-cost credit insurance. The complaint also charged The Associates with violations of the FTC Act, including unfair collection practices, failure to disclose the costs and terms of credit insurance and various misrepresentations about loan terms. The complaint further charged The Associates with violating the TILA, Regulation Z, and the FTC Act by splitting one loan into two separate transactions, failing to provide required disclosures, and disbursing money prior to expiration of the rescission period. The consent order involved the largest consumer protection redress order in FTC history. Under the consent order, Citigroup⁴ will provide redress – expected to approximate \$215 million – to consumers who bought credit insurance in connection with loans made by The Associates over a five-year period. The consent also mandates certain reporting and record keeping requirements.⁵ The federal district court in Atlanta granted preliminary approval of the stipulated final judgment and order in September 2002;⁶ a final fairness hearing and decision is expected in early 2003. Citifinancial has announced that it no longer sells single premium credit insurance on mortgage loans, and has committed to improving its sales process to better inform consumers of the optional nature of credit insurance products.

The Commission also settled charges against First Alliance Mortgage Company ("First Alliance") and two affiliated companies for violations of the TILA, Regulation Z, and the FTC Act.⁷ The agreement

³ Federal Trade Commission v. Citigroup Inc., No. 1:01-CV-0606 (N.D. Ga. Sept. 24, 2002).

⁴ Citigroup acquired The Associates in November 2000 and merged The Associates' consumer finance operations into its subsidiary, Citifinancial. The Commission's complaint alleged that Citigroup and CitiFinancial were liable as successor corporations to The Associates.

⁵ The consent order is combined with a pending California class action case. Morales, et al. v. Citigroup, Inc., et al., ("Citigroup Loan Cases") JCCP No. 4197 (Cal. Super. Ct. Nov. 13, 2002). The class action portion of the settlement will provide an additional \$25 million to a subclass of consumers whose mortgage loans were repeatedly refinanced by The Associates.

⁶ In the Citigroup Loan Cases, the California court granted preliminary approval of the settlement and certification of a nationwide settlement class in November 2002.

⁷ The Federal Trade Commission v. First Alliance Mortgage Co., No. SACV 00-964 DOC (EEx) (C.D. Cal. Sept. 18, 2002).

was reached through a joint effort of several governmental agencies, including the states of Arizona, California, Florida, Illinois, Massachusetts, and New York, and counsel for private plaintiffs. The agreement settles charges that First Alliance and its chief executive officer, Brian Chisick, violated the TILA, Regulation Z, and the FTC Act in making home mortgage loans to consumers. Among other things, the complaint charged defendants with making misleading statements about material terms of the home mortgage loans and the meaning of material information used in the TILA disclosure, in violation of the FTC Act. The complaint also charged that defendants misled consumers about the existence and amount of loan origination fees and about the interest rate and monthly payments on short-term “teaser rate” adjustable rate mortgage loans, which led consumers to believe they were borrowing less money at lower interest rates than they actually were. The settlement, finalized in September 2002, provides a consumer redress fund that will include all of the remaining assets of First Alliance and its affiliates as well as a payment of \$20 million from Brian Chisick and his wife, Sarah Chisick. Nearly 18,000 borrowers will share approximately \$60 million in compensation under the terms of the settlement, which permanently enjoins First Alliance and the Chisicks from, among other things, making such misrepresentations in the future.⁸

The Commission settled charges brought in federal district court against Mercantile Mortgage Company, Inc. and two of its officers, Bran Silveous and Ronald Noble (“Mercantile”).⁹ The complaint charged that the defendants, through their employees and a third-party broker named Mark Diamond, violated, among other things, the FTC Act, TILA, and Home Ownership and Equity Protection Act (“HOEPA”).¹⁰ The complaint charged that defendants engaged in numerous deceptive and other illegal practices to induce consumers to borrow from Mercantile. The complaint also charged that defendants made misrepresentations about key terms and costs of their mortgage loans – including about the interest rate, monthly payment, and prepayment penalty – and failed to make required disclosures at loan closings. According to the complaint, in many instances, Mercantile failed to disclose a balloon payment on HOEPA disclosure forms and/or provide HOEPA disclosures at all. The consent order requires defendants to pay \$250,000 in consumer redress and creates a program to offer refinanced loans on favorable terms to certain borrowers with balloon loans. As part of the program, Mercantile will pay all or virtually all of the closing costs for the refinancing, including its own fees and those imposed by third parties. Mercantile must offer the lowest interest rate available for each specific borrower, given the

⁸ The agreement also settles various state law charges regarding First Alliance’s home mortgage loans.

⁹ United States of America and State of Illinois, ex rel. Attorney General James E. Ryan v. Mercantile Mortgage Company, Inc., Bran Silveous, and Ronald Noble, No. 1:02-CV-5079 (N.D. Ill. July 18, 2002). The Department of Housing and Urban Development (“HUD”) joined the case with respect to alleged violations of RESPA; the State of Illinois joined the case with respect to various alleged state law violations.

¹⁰ In this report, HOEPA (which regulates certain high-rate, high-fee mortgage loans and amends the TILA and Regulation Z) is referenced separately.

borrower's credit rating. The consent order also permanently enjoins the defendants from misrepresenting the terms, costs, or other conditions of any loan to consumers and from violating the TILA, HOEPA, RESPA, and other requirements.

In an action related to Mercantile, the Commission filed a complaint in federal district court against mortgage broker Mark Diamond ("Diamond") and OSI Financial Services, Inc., a company wholly owned and controlled by Diamond, charging them with deceiving borrowers about the terms of their loans.¹¹ According to the complaint, Diamond referred many of his brokered loans to Mercantile. The complaint charged that, among other things, in some instances Diamond presented consumers with incomplete loan documents, including TILA disclosure statements in which the terms of the loan, such as the APR, monthly payment amount, and/or balloon payment amount, were left blank.

The Commission continued its litigation against Capital City Mortgage Corp. ("Capital City Mortgage") and its owner, Thomas K. Nash, for violations of federal laws, *inter alia*, the TILA and Regulation Z and the FTC Act.¹² The complaint's allegations include that defendants engaged in unfair or deceptive acts or practices, in violation of the FTC Act, in offering and extending credit and through the loans, with the result that a number of borrowers were overcharged on their loans, were defaulted, and had title to their homes or other property impaired or completely lost (along with the equity). The case, initially scheduled for trial in April 2002, was postponed due to the death of Mr. Nash. Thereafter, the court granted the Commission's request to substitute the estate of Mr. Nash as a defendant, and temporarily granted the Commission's motion for an asset freeze.¹³ The Commission's motion to add relief defendants, including various trusts and family members receiving the bulk of Mr. Nash's assets outside the probate estate, is still pending before the court. A new trial date has not been set.

B. Other TILA Cases

The Commission filed a complaint in federal district court charging National Audit Defense Network, Inc. ("NADN"); Tax Coach, Inc. (doing business as Tax Ready ("Tax Ready")) and various officers of both companies with violations of the FTC Act and/or TILA and Regulation Z regarding various misrepresentations about refunds and the failure to timely credit consumers' credit card accounts after

¹¹ Federal Trade Commission and State of Illinois, ex rel. Attorney General James E. Ryan v. OSI Financial Services, Inc. and Mark Diamond, No. 02-CV-5078 (N.D. Ill. filed July 18, 2002). An amended complaint was filed on Nov. 1, 2002, regarding certain state law issues. The State of Illinois joined the case with respect to the alleged state law violations.

¹² Federal Trade Commission v. Capital City Mortgage Corp., No. 1:98CV00237 (D.D.C. filed Jan. 29, 1998).

¹³ Id. (D.D.C. order granting FTC's motion for leave to file supplement to motion to amend, dated Oct. 31, 2002).

accepting the return of tax-information products or otherwise acknowledging that refunds were owed.¹⁴ According to the complaint, NADN and Tax Ready advertise programs and services that purport to assist consumers in reducing their tax liabilities; the companies also advertise an unconditional 30-day money-back guarantee and guaranteed tax savings of \$3,000. The court has issued a temporary restraining order and asset freeze and appointed a receiver to take control of the companies.

The Commission also filed a complaint in federal district court charging Canadian-based Consumer Alliance, Inc. ("Consumer Alliance") with, among other things, deceptively marketing worthless credit-card protection programs to U.S. consumers, making various misrepresentations to induce consumers to disclose their credit card account numbers, and causing charges to be posted on those accounts.¹⁵ Although the allegations in the complaint are based solely on violations of Section 5 of the FTC Act and the Telemarketing Sales Rule ("TSR"), the facts of the case involve the TILA and Regulation Z. Specifically, the defendants allegedly represented to consumers that, without the credit-card protection program, they would be held fully liable for any unauthorized charges made to their credit card accounts. In truth and in fact, under the TILA a consumer cannot be held liable for more than \$50 for any unauthorized charges to a credit card account.

C. Other Initiatives

In 2002, the Commission's staff filed comments on HUD's proposed amendments to regulations implementing the Real Estate Settlement Procedures Act ("RESPA").¹⁶ Among other things, the comments supported HUD's initiative to encourage packaging of settlement services by providing

¹⁴ Federal Trade Commission v. National Audit Defense Network, Inc., et al., No. CV-S-02-0131 (D. Nev., filed Jan. 30, 2002).

¹⁵ Federal Trade Commission v. Consumer Alliance, Inc., et al., No. 1:02-CV-2429 (N.D. Ill., filed Apr. 4, 2002).

¹⁶ Comments of the Staff of the Bureau of Economics, Bureau of Consumer Protection and Office of Policy Planning of the Federal Trade Commission to the Department of Housing and Urban Development, Docket No. FR-4727-P-01 (October 28, 2002). A copy of the staff comments is published on the FTC's website at <http://www.ftc.gov/be/v030001.pdf>. The comments supported HUD's goal of simplifying the mortgage process and enhancing competition but also urged HUD, when evaluating proposed changes, to conduct consumer research to determine whether the proposed changes will enhance consumer understanding of the mortgage process. The comments also stressed the need to conduct consumer research to determine whether the proposals will enhance consumer comprehension of the process regarding: 1) the disclosure of mortgage broker compensation, including yield spread premiums; 2) the revision of settlement forms; and 3) enhancing the reliability of settlement costs.

packagers with a safe harbor from certain RESPA liability if they abide by the regulations. The comments raised, however, whether, in view of the potential cost savings, packaging should also be made available for HOEPA loans. The comments also addressed the proposal's potential impact related to the TILA and HOEPA. Regarding HUD's proposed changes to the Good Faith Estimate of Settlement Costs ("GFE"), the comments supported HUD's proposal to require lenders to disclose certain key loan terms on the GFE. However, the comments stated that consumers and lenders will benefit if the new GFE contains terms and disclosures consistent with those already required by the TILA.

D. Consumer and Business Education

The Commission continues to view consumer and business education efforts as important complements to its enforcement activities. In 2002, the Commission issued updates to various consumer publications relating to the TILA to provide up-to-the-date information to consumers. In addition, the Commission issued new TILA-related publications, including "Billed For Merchandise You Never Received" and "Credit Insurance: Is It For You?" All of the Commission's consumer protection materials were made available to the public, among other means, through the Commission's website.

Equal Credit Opportunity Act

In calendar year 2002, the Commission settled one action and continued its litigation against another mortgage lender for alleged violations of the ECOA and Regulation B. Other enforcement efforts continue.

First, the Commission settled its action against The Associates and others, discussed above, which alleged, among other things, that The Associates failed to maintain consumers' loan applications and certain related records, in violation of Regulation B. As a part of the settlement agreement, Citifinancial must adhere to certain record keeping and reporting requirements consistent with the ECOA and Regulation B.

Second, the Commission's ongoing litigation against Capital City, discussed above, among other things, involves charges that the company and its owner, Thomas K. Nash, 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 with respect to defendants Capital City and Nash. This case seeks an order awarding equitable relief and/or civil penalties.

The Commission continued its consumer and business education efforts, including efforts to increase awareness of and compliance with the ECOA. The Commission also continued its participation in the Interagency Task Force on Fair Lending.

Dolores S. Smith, Director
December 18, 2002
Page 7

Electronic Fund Transfer Act

In 2002, the Commission continued its consumer and business education efforts in this area. The Commission issued updates to various consumer publications, including "Credit, ATM & Debit Cards: What To Do If They're Lost Or Stolen;" "Fair Credit Billing;" and "Consumer's Guide to Electronic Payments." These publications are essential to providing consumers with information on how to safely utilize new forms of electronic banking and are available to the public via the Commission's website.

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

The Commission has no recommendations for changes in these Acts or their implementing regulations at this time.

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 Joel Winston, Associate Director, Division of Financial Practices, at (202) 326-3224.

By direction of the Commission.

Donald S. Clark
Secretary