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PREPARED STATEMENT OF THE FEDERAL TRADE COMMISSION

before the

CALIFORNIA STATE ASSEMBLY COMMITTEE ON BANKING AND FINANCE

on

Predatory Lending Practices in the Home-Equity Lending Market

February 21, 2001

I. INTRODUCTION

I am Ronald G. Isaac, Assistant to the Director of the Federal Trade Commission's Bureau of Consumer Protection.(1) I appreciate the opportunity to appear before you today to discuss the serious problem of abusive lending practices in the subprime lending industry, commonly known as "predatory lending." I will provide an overview of predatory lending practices and problems that are occurring in the growing subprime industry and I will discuss the Commission's recent activities in this area. In addition, I understand that the Committee is interested in the Federal Reserve Board's Regulations Z and C. Last September the Commission provided recommendations to the Board of Governors of the Federal Reserve System (the Board) about addressing problems in the subprime lending market. This testimony is available on the Commission's website at www.ftc.gov. The Commission is reviewing the Board's December 15, 2000 proposed regulatory changes addressing predatory lending, and the Commission will forward to the Committee any additional comments that it makes to the Board on these issues. Now, however, let me briefly speak about the Commission's role in enforcing laws that bear on these problems.

The Commission has wide-ranging responsibilities concerning nearly all segments of the economy, including jurisdiction over most non-bank lenders.(2) As part of its mandate to protect consumers, the Commission enforces the Federal Trade Commission Act ("FTC Act"), which broadly prohibits unfair or deceptive acts or practices in or affecting commerce.(3) The Commission also enforces a number of laws specifically governing lending practices, including the Truth in Lending Act ("TILA"),(4) which requires disclosures and establishes certain substantive requirements in connection with consumer credit transactions; the Home Ownership and Equity Protection Act ("HOEPA"),(5) which, as part of the TILA, provides special protections for consumers in certain non-purchase, high-cost loans secured by their homes; and the Equal Credit Opportunity Act ("ECOA"),(6) which prohibits discrimination against applicants for credit on the basis of age, race, sex, marital status, or other prohibited factors. In addition to our enforcement duties, the Commission also responds to many requests for information about credit issues and consumer credit laws from consumers, industry officials, state law enforcement agencies, and the media.(7)

II. THE GROWING PREDATORY LENDING PROBLEM

Subprime lending refers to the extension of credit to persons who are considered to be higher-risk borrowers, also commonly referred to as "B/C" or "nonconforming" credit.(8) Loans to subprime borrowers serve communities that may have been underserved by lenders in the past. In recent years, subprime mortgage lending has grown dramatically. As a percentage of all mortgage originations, the subprime market share increased from less than 5 percent in 1994 to almost 13 percent in 1999.(9) In 2000 alone, subprime lenders originated over $140 billion in home

equity loans.(10) This is a $15 billion increase from 1997, when subprime lenders originated $125 billion in home equity loans.(11)

At the same time that subprime loans have become a significant and growing part of the home equity market, the composition of companies involved in the subprime market has been evolving. This may be attributable in part to the increasingly important role that Wall Street investment banks have played over the last five years in raising funds for subprime loans. In 1995, $18.5 billion in subprime loans was securitized; in 2000, that figure was almost $56 billion.(12) The secondary market's expansion has, in turn, helped to sustain growth in the industry by enabling lenders to raise funds on the open market to expand their subprime lending activities.(13)

Predatory lending practices often exploit lower-income and minority borrowers.(14) In many cases, those living in lower-income and minority neighborhoods -- where traditional banking services continue to be in short supply -- tend to turn to subprime lenders regardless of whether they would qualify for less expensive loans. Subprime loans are three times more likely in low-income neighborhoods than in high-income neighborhoods.(15) In predominately black neighborhoods, subprime lending accounted for 51 percent of refinanced loans in 1998 -- compared to only 9 percent in predominately white areas.(16) Significantly, these disparities still existed when borrowers in black and white neighborhoods were compared while controlling for the income levels of the neighborhood.(17) Elderly homeowners, in particular, are frequent targets of some subprime home equity lenders, because they often have substantial equity in their homes, yet have fixed or declining incomes.(18) While subprime lenders may expand access to credit for individuals who otherwise would be shut out of the market, unethical lenders may take advantage of consumers in the weakest bargaining position.

The subprime mortgage market has flourished because such lending has been profitable, demand from borrowers has increased, and secondary market opportunities are growing. Lenders typically charge consumers a higher interest rate and fees for subprime loans than for conventional loans. Higher rates and points can be appropriate where greater credit risks are involved, as is often the case with subprime loans. Critics assert, however, that the interest rates and fees charged by some subprime lenders are excessive, and much higher than necessary to cover increased risks, particularly since these loans are secured by the value of a home.

III. THE PROBLEM OF PREDATORY LENDING PRACTICES

The enormous growth of the subprime mortgage industry has enabled many consumers, who previously would have had much more limited access to the credit market, to obtain home loans. It is critically important for consumers, especially those who live in lower-income communities, to have access to credit. However, this access should not be based on predatory lending practices that take advantage of borrowers. Predatory lending practices hide from consumers essential information they need to make decisions about their single greatest asset -- their home -- and the equity they have spent years building. Predatory lending practices are particularly harmful because these loans usually are sought at a time of great need, when borrowers are most susceptible to practices that can strip them of substantial sums of money and, ultimately, their homes.

Predatory lending in the subprime mortgage market covers a wide range of practices. While the practices are quite varied, there are common traits. They generally aim either to extract excessive fees and costs from the borrower or to obtain outright the equity in the borrower's home. This is often accomplished through a combination of aggressive marketing practices, high-pressure sales tactics, and loan terms, such as prepayment penalties, that inhibit a borrower's ability to go elsewhere for credit.

Among the most harmful of these practices is "equity-stripping."(19) This often begins with a loan that is based on equity in a property rather than on a borrower's ability to repay the loan -- a practice known as "asset-based lending." As a general rule, loans made to individuals who do not have the income to repay such loans are designed to fail, and they frequently result in the lender acquiring the borrower's home equity. The borrower is likely to default and ultimately lose her home through foreclosure or by signing over the deed to the lender in lieu of foreclosure. Such a

scheme is particularly abusive because these vulnerable borrowers often have no significant assets except the equity in their homes.(20)

Another practice of serious concern is "packing," which is the practice of adding credit insurance or other "extras" to increase the lender's profit on a loan.(21) Lenders often stand to make significant profits from credit insurance and therefore have strong incentives to induce consumers to buy it as part of the loan.(22)

Typically, the insurance or other extra is included automatically as part of the loan package presented to the borrower at closing, and the premium is financed as part of the loan. The lender often fails to provide the borrower with prior notice about the insurance product(23) and then rushes the borrower through the closing. Sometimes, the lender represents that the insurance "comes with the loan," perhaps implying that it is free. Other times, the lender simply may include the insurance in the loan closing papers with no explanation. In such a case, the borrower may not understand that the insurance is included or exactly what extra costs it adds to the loan. Even if the borrower understands and questions the inclusion of the insurance in the loan, subprime borrowers often are not in a position to negotiate loan terms. They often need to close the loan quickly, due to high debt, limited financial resources, and limited financing options. Therefore, they generally will not challenge the loan at closing if they believe or are told that any changes may cause a problem or delay in getting the loan.

Lenders are not prohibited by federal law from requiring the purchase of credit insurance with a loan, as long as they include the price of the premium in the finance charge and annual percentage rate. As described above, however, sometimes the lender effectively requires the purchase of credit insurance with the loan, but fails to include the premium in disclosures of the finance charge and annual percentage rate, as mandated under the Truth in Lending Act.(24) When the lender excludes the required insurance premium from the borrower's disclosures, the cost of credit may appear significantly lower than the true cost of the credit. As a result, the consumer cannot make an informed decision about the cost of the loan.(25)

Another practice that has received attention is "flipping," the practice of inducing(26) a consumer to refinance a loan repeatedly, often within a short time frame, charging high points and fees each time.(27) This causes the borrower's debt to increase steadily. Although a consumer's debt may be on the rise anyway if she or he borrows money in connection with the refinancing, in some cases, the amount of cash received may be smaller than the additional costs and fees charged for the refinancing. While a consumer's option to refinance is an integral part of a functioning mortgage market, subprime lenders engaged in "flipping" may misrepresent to the borrower the terms and ultimate benefits of the transaction, or induce the borrower to take on more debt than she can handle. By taking advantage of its unequal relationship with a particularly vulnerable consumer, an unscrupulous lender can compromise a borrower's ability to make an informed choice about financing options.

Another reported abuse in the subprime mortgage industry is the targeting of consumers by home improvement contractors who are effectively working as agents of lenders.(28) One alleged abuse involves contractors who obtain the borrower's consent for a loan with high rates and fees through the use of deception or coercion. For example, the contractor and homeowner may agree on a price for certain work. The contractor, after beginning work on the

home, may then present the homeowner with loan documents from the lender indicating higher rates and fees than those agreed upon. The consumer feels pressured to sign the papers as drafted -- especially when faced with the prospect of leaving the improvements unfinished. In another reported scenario, the contractor may receive the loan proceeds directly or indirectly from the lender without providing any services to the homeowner, or without providing services commensurate with the amount of the payment. Nevertheless, the lender may still demand full payment from the homeowner.

Predatory practices by home improvement contractors and their affiliated lenders(29) are particularly problematic because the targeted homeowners often start out with no mortgage at all or a market-rate first mortgage that they later are induced to refinance. Because of the home improvement scheme, however, a homeowner with an affordable

mortgage or no mortgage, who is seeking aluminum siding or new windows, may suddenly find herself with a high-cost home equity loan.(30)

After a loan is closed, consumers may be subject to loan servicing practices that extract monies not owed under the loan terms or that inhibit refinancing options with another lender.(31) A lender may provide inaccurate monthly-payment demands, adding fees and charges that are not owed. Because of the complexities of loan terms, it is difficult for the borrower to know whether the lender's payment demands are accurate. A lender also may fail to provide the consumer with full or accurate pay-off information and, at the same time, aggressively solicit the borrower to refinance with the lender. Consequently, the borrower becomes tied to a lender without a means of escape.(32)

Some of these predatory lending practices may be illegal under various federal or state laws, including a number of laws enforced by the Commission. Depending on the particular facts, some of the practices may constitute deceptive or unfair practices in violation of Section 5 of the FTC Act or a comparable state statute. In addition, some of these practices may constitute violations of the TILA, as well as violations of the protections for high-rate and high-fee loans under HOEPA. If a lender charges similarly-qualified borrowers higher prices based on age, race, and/or sex, such a practice would constitute pricing discrimination in violation of the ECOA.(33) Additionally, if a lender targets borrowers for predatory practices based on age, race and/or sex, such targeting, depending on the facts, also could violate the ECOA.(34)

IV. THE COMMISSION'S RESPONSE

Given this background, the Commission is taking a variety of steps to address abuses in the subprime market. The Commission has increased its enforcement activities to halt illegal lending practices engaged in by subprime lenders. At the same time, the Commission has been working with other federal agencies and the states to increase and coordinate enforcement efforts. The Commission also is educating consumers to help them avoid predatory lending practices.

Enforcement actions have addressed a variety of predatory practices. Most recently, the Commission challenged deceptive sales techniques and related conduct in its suit against the First Alliance Mortgage Companies.(35) The defendants, a subprime lender based in Orange County, California, its parent company, and a Minnesota affiliate, marketed high-cost home equity loans to vulnerable borrowers through misleading statements and aggressive sales tactics that were designed to obfuscate the true meaning and significance of TILA-required disclosures. As the Commission has learned through its investigations of predatory lending practices, deceptive sales techniques may successfully confuse borrowers about actual loan terms, notwithstanding the provision of disclosures required by TILA.(36)

In March 2000, the Commission, in conjunction with the United States Department of Justice ("DOJ") and the Department of Housing and Urban Development ("HUD"), announced a settlement with Delta Funding Corporation, a national subprime mortgage lender. In addition to the allegations brought by DOJ and HUD, the Commission alleged that Delta had engaged in a pattern or practice of asset-based lending and other practices in violation of HOEPA. Specifically, Delta allegedly extended high-cost loans to borrowers based on the borrower's collateral, rather than considering the borrower's income, obligations, and employment status to determine whether the borrower was able to make the scheduled payments. In these instances, prudent underwriting criteria would have revealed factors such as high debt-to-income ratios with minimal residual income, unverified income, and higher monthly payments for a borrower already in default indicating that the borrower was likely to have difficulty repaying the loan. The settlement, which provided for nationwide injunctive relief, also resolved allegations by DOJ of violations of the ECOA and by HUD of violations of the Real Estate Settlement Procedures Act.(37)

In July 1999, as part of "Operation Home Inequity," the Commission settled cases against seven subprime mortgage lenders, including Barry Cooper, a California-based creditor, for violations of TILA, including HOEPA, and Section 5 of the FTC Act.(38) In its settlement agreement with Cooper, the Commission resolved allegations that the Encino lender had violated those statutory provisions by imposing prohibited prepayment penalties and engaging in asset-

based lending. Cooper agreed to pay redress to consumers and to reform the terms of loans that contained the illegal prepayment penalties. Further, for a period of five years, Cooper was enjoined from issuing additional HOEPA loans unless certain conditions were met.(39)

Other HOEPA violations addressed in these cases included the failure to provide required disclosures and the use of prohibited terms (such as balloon payments on loans with less than five-year terms and increased interest rates after default). The "Operation Home Inequity" settlement agreements provide for substantial remedies and protections for past and future borrowers, including consumer redress totaling $572,500, and, in the case of one lender, a ban against any future involvement with high-cost loans secured by consumers' homes.(40) More recently, the Commission settled a case against a Washington State lender, Nu West, Inc., that included an allegation that the lender violated HOEPA by making direct payments to home improvement contractors. The settlement required the defendants to pay more than $160,000 in consumer redress.(41)

In July 1999, the Commission settled charges that another mortgage lender, Fleet Finance, Inc., had failed to provide accurate, timely disclosures of the costs and terms of home equity loans to consumers and had failed to provide or accurately provide consumers with information about their right to cancel their transactions, in violation of the TILA and Section 5 of the FTC Act. The settlement provides for $1.3 million in consumer redress as well as injunctive relief.(42)

In January 1998, the Commission filed a complaint in the United States District Court for the District of Columbia against Capital City Mortgage Corporation, a Washington, DC-area mortgage lender, and its owner, alleging numerous violations of various federal laws resulting in serious injury to borrowers, including the loss of their homes.(43) The company allegedly made home equity loans to minority, elderly, and low-income borrowers at interest rates as high as 20-24 percent. Many borrowers faced foreclosure on their properties, after which the company would allegedly buy the properties at auction for prices much lower than their appraised value. The Commission's complaint in this matter, which remains in litigation, alleges violations of the FTC Act, the TILA, the ECOA, and the Fair Debt Collection Practices Act.(44)

In the area of loans sold with credit insurance (i.e., "packing"), the Commission has a long enforcement history. The Commission settled a case in 1997 against The Money Tree, a Georgia-based consumer finance lender, and its president. The case involved, in part, allegations that the company required consumers to purchase credit-related insurance and other "extras" along with their loans, without disclosing to consumers the true cost of their credit. The settlement, among other things, requires The Money Tree to offer refunds of certain insurance premiums to customers whose loans were open at the time the settlement became final. It also mandates that the company approve borrowers' loan applications prior to any discussion with the borrower about credit insurance and requires that the company provide expanded disclosures.(45) In 1992, the Commission approved a consent agreement with Tower Loan of Mississippi settling similar charges regarding its consumer loans.(46)

These cases, as well as earlier enforcement actions,(47) have provided an important foundation for the Commission in its investigations of potential packing practices in home equity lending. For example, this past summer the Commission jointly settled a case, along with HUD, against Action Loan Company, Inc., of Louisville, Kentucky, and its owner and president, requiring the defendants to pay a $350,000 civil penalty and up to a total of $37,000 in consumer redress. The complaint included allegations that the defendants violated the TILA and Regulation Z by failing to include the cost of accident and health insurance in their disclosure of the finance charge and annual percentage rate of a consumer loan and that they violated Section 5 of the FTC Act by misrepresenting that consumers were purchasing only credit life insurance when, in fact, they were also purchasing accident and health insurance.(48)

In addition to its ongoing investigations, the Commission is sharing its knowledge and experience with other enforcement agencies and with consumers. In 1997, the Commission's Bureau of Consumer Protection held joint law enforcement sessions on home equity lending abuses with state regulators and law enforcers in six cities around the

country. These training sessions were conducted to assist states in exercising their relatively new enforcement authority under HOEPA(49) and to share information about recent trends.

The Commission has implemented an aggressive consumer education program and has published a series of free publications specifically for homeowners and potential home buyers. For example, in 1996, the Commission first produced "*High-Rate, High-Fee Loans (Section 32 Mortgages*)" to alert homeowners about their rights under HOEPA. In 1998, in conjunction with the filing of the Capital City complaint, the Commission issued two publications to help consumers recognize and avoid home equity scams and abuses: "*Avoiding Home Equity Scams" and "Home Equity Loans: Borrowers Beware*." In January 1999, the Commission, along with ten other federal agencies, including the Federal Reserve Board, produced "*Looking for the BEST Mortgage - Shop, Compare, Negotiate*" to help consumers shop for home loans. During National Consumer Protection Week in February 1999, which highlighted credit fraud and abusive lending practices, the Commission distributed more than 500,000 credit-related publications. As part of "Operation Home Inequity" in July 1999, the Commission partnered with AARP to produce "*Need a Loan? Think Twice About Using Your Home as Collateral*."(50) In fiscal year 2000, the Commission distributed approximately 200,000 free publications on home equity lending, including over 50,000 online publications. The Commission is actively continuing its consumer education program in 2001; last month, the Commission published a new consumer alert about home-equity lending, "*Shopping for a Home Equity Loan*?" Most recently, National Consumer Protection Week 2001 focused on educating consumers about abusive lending practices.

V. CONCLUSION

The Commission is continuing to examine and take appropriate law enforcement action regarding the problem of predatory lending. Due to sharp growth in the subprime mortgage industry, it appears that predatory lending practices are also on the rise. As a result of unfair and deceptive practices and other federal law violations by certain lenders, vulnerable borrowers are facing the possibility of paying significant and unnecessary fees and, in some cases, losing their homes. Using its enforcement authority, the Commission continues to work to protect consumers from these abuses.

ENDNOTES

1. This comment represents the views of the Federal Trade Commission. Responses to any questions you have are my own and do not necessarily reflect the Commission's views or the views of any individual Commissioner.

2. See, e.g., 15 U.S.C. § 45(a); 15 U.S.C. § 1607.

3. See 15 U.S.C. § 45(a).

4. See 15 U.S.C. § 1601-1667(f).

5. See 15 U.S.C. § 1639.

6. See 15 U.S.C. § 1691.

7. A number of the remarks in this testimony are based on the Commission's administrative and enforcement experience in the area of home equity lending, including consultations with individual consumers, consumer groups, and industry officials.

8. Credit to "prime" borrowers, generally borrowers with good credit histories, is referred to as "A" credit. "A" mortgage loans are those that conform to the secondary market standards for purchase by the government-sponsored entities Fannie Mae and Freddie Mac (although Fannie Mae and Freddie Mac recently began purchasing "A minus" subprime loans).

9. See *Curbing Predatory Home Mortgage Lending: A Joint Report, United States Department of the Treasury and United States Department of Housing and Urban Development*, June 2000 ("HUD/Treasury Report") at 27-28.

10. See Top 25 B & C Lenders in 2000, Inside B & C Lending, Feb. 16, 2001, at 1.

11. See Top 25 B & C Lenders in 1997, Inside B & C Lending, Feb. 16, 1998, at 2.

12. See HUD/Treasury Report, supra note 9, at 40; Top Securitizers, Inside B & C Lending, Jan. 8, 2001, at 2-3.

13. See Martin Wahl and Craig Focardi, *The Stampede*, Mortgage Banking, Oct. 1997, at 26, 29. Growth in subprime originations also has been aided somewhat by the increasing availability of warehouse lines of credit, which provide short-term funding to lenders for the purpose of loan financing. See *Warehouse Lines of Credit: Limited for B & C Lender*s?, Inside B & C Lending, Feb. 17, 1997, at 9.

14. See Complaint, F.T.C. v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998); Anastasia Hendrix, *Oakland Widow: They Stole My House*, S.F. Examiner, Apr. 13, 1997, at A-1; Kay Stewart & David Heath, *High-Cost Loans Trap Those Least Able To Afford It*, Louisville Courier-Journal, Feb. 16, 1997, at 16-17; Lucille Renwick, *Wolf at the Door*, L.A. Times, Mar. 14, 1993, at 16.

15. See HUD/Treasury Report, supra note 9, at 45.

16. Id. Home Mortgage Disclosure Act (HMDA) data indicate that borrowers in black neighborhoods are five times as likely to refinance in the subprime market than borrowers in white neighborhoods. Id. at 45.

17. Id. at 45-46.

18. For example, the Department of Justice announced a settlement in September 1996 with Long Beach Mortgage Company addressing allegations, inter alia, that the company discriminated against the elderly, African Americans, Latinos, and women by charging higher rates than were offered to other similarly-qualified borrowers. The combination of these factors was alleged to be crucial. For example, African American females over the age of 55 were 2.6 times more likely than white males under age 56 to be charged fees and points that amounted to 6% or more of the loan amount. See Complaint, United States v. Long Beach Mortgage, Civ. No. 96-6159DT (CWX) (C.D. Cal. filed Sept. 5, 1996).

19. See United States of America v. Delta Funding Corporation and Delta Financial Corporation, Civ. Action No. 00 1872 (E.D.N.Y.) (April 2000) (settling FTC allegations that Delta engaged in a pattern or practice of asset-based lending, in violation of HOEPA).

20. While HOEPA prohibits a pattern or practice of asset-based lending, this proscription only applies to the narrow set of high-rate and high-fee loans covered by the statute and does not apply at all to purchase-money loans. See 15 U.S.C. § 1639; 12 C.F.R. § 226.32.

21. See The Money Tree, 123 F.T.C. 1187 (1997) (settling allegations that credit insurance and auto club memberships were required but not included in finance charge and APR disclosures in violation of the TILA and, in certain instances, the FTC Act); Tower Loan of Mississippi, 115 F.T.C. 140 (1992) (same).

22. The guidelines established by the National Association of Insurance Commissioners suggest that lenders and insurers may retain up to 40 cents on the dollar from premiums paid by borrowers, with 60% of premium payments paid out for claims. In most states, however, lenders and insurers retain more than 40% of premium monies; in some states, they keep up to 70% or 80% of the proceeds. See Jane Bryant Quinn, *Credit Life Insurance Often Overpriced*, Wash. Post, Feb. 9, 1997, at H2.

23. This scenario is known as "bait and switch" because the closing papers differ from the loan package previously discussed with the borrower.

24. See 12 C.F.R. § 226.4(b)(7). Typically, lenders can easily induce borrowers to sign a line in the thick package of complex loan closing papers indicating that the purchase of insurance is voluntary when, in fact, they have little choice if they want to close the loan at that time. Whether credit insurance is in fact required or optional is a factual question. See Federal Reserve Board, Official Staff Commentary to Regulation Z, § 226.4(d)(5).

25. Lenders have incentives to omit required credit insurance premiums from the disclosures of the annual percentage rate and finance charge. First, the appearance of a lower rate may induce the borrower to follow through on the transaction. Second, the lower figure may cause the lender's annual percentage rate to appear to fall below state rate ceilings or HOEPA triggers, which it may in actually exceed.

26. One method of inducing a borrower to refinance is by issuing a balloon note -- particularly one in which the borrower is paying only interest -- where the note comes due in a relatively short period of time. When the note comes due and the borrower owes a substantial lump sum -- sometimes equal to the entire principal of the original loan -- the borrower must again obtain a loan in order to finance the balloon payment that is due at that time.

27. See, e.g., Kay Stewart, *Widow Sold Her House To Pay Loan She'd Hoped Would Ease Her Debts*, Louisville Courier-Journal, Feb. 16, 1997, at 16 (lender refinanced borrower's loan four times in nine months). Lenders in the consumer finance industry have long relied on refinancing, and sometimes repeated refinancing, as a source of business. See W. Artz & R. Neihengen, Jr., Analysis of Finance Company Ratios in 1994, 78 J. Commercial Lending 33, 37 (Sept. 1995) (showing that, from 1990 to 1992, companies refinanced existing loans to present borrowers in a range of 63% to 66.8% of the cases); Report of the Presiding Officer on Proposed Trade Regulation Rule: Credit Practices, Federal Trade Commission, Aug.1978, at 43-44 (creditors self-reported refinancing loans for existing customers in a range of 35% to 75% of accounts, with an average of 56.5%).

28. See Complaint, Newton v. United Cos. Fin. Corp., Civ. No. 97-CV-5400 (E.D. Pa filed Sept. 2, 1997) (class action suit on behalf of low-income borrowers who paid fees and charges of up to 50% of the cost of the home improvements); Complaint, Harris v. Green Tree Fin. Corp., Civ. No. 97-CV-1128 (E.D. Pa filed Feb. 14, 1997) (class action suit challenging deceptive home improvement loan contracts); see also Stuart L. Ditzen, *From Home Loans to Lawsuits, Phila. Inquirer*, Dec. 17, 1997, at B1.

29. Although a consumer targeted by a home improvement contractor often has no direct contact with the lender, the consumer generally still can bring an action against the lender. The contractor, pursuant to the Commission's Trade Regulation Rule on Preservation of Consumer Claims and Defenses, known as the Holder Rule, is obligated to include in the consumer's loan documents a provision stating, in part, that "any holder of [that] consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services . . . ." See 16 C.F.R. § 433.2. Therefore, depending on the facts of a particular case, the lender could be subject to any claims that the borrower could have brought against the contractor. If the contractor omits this language from the loan documents, the omission itself would constitute a violation of the Holder Rule.

30. Lenders also have incentives to refinance a homeowner's existing mortgage rather than to merely originate a new loan for the home improvements. First, lenders generally seek to originate one combined loan rather than offering only a second mortgage for the smaller cost of the improvements. This allows the lenders to maximize fees based on the loan principal. Second, lenders generally prefer the initial lien position because of the benefits that would accrue to them in the event of a borrower's bankruptcy. Third, under current federal law, state usury caps do not apply to first liens. See 12 U.S.C. § 1735f-7.

31. See Complaint at 11-13, F.T.C. v. Capital City Mortgage Corp., No. 1:98-CV-00237 (D.D.C. filed Jan. 29, 1998). See infra note 43 and accompanying text for a discussion of this case.

32. A borrower also may be tied to a lender if the lender's appraisal intentionally and significantly overvalues the property because the borrower's loan-to-value ratio may be too high for refinancing. This is known as a "bumped appraisal."

33. See supra note 18 for a discussion of the Department of Justice's settlement with Long Beach Mortgage.

34. See Brief of the United States As Amicus Curiae, dated March 10, 2000, in Hargraves v. Capital City Mortgage Corp., Civ. Action No. 98-1021 (JHG/AK).

35. Complaint, F.T.C. v. First Alliance Mortgage Co., Docket No. SA CV 00-964 DOC (C.D. Cal. filed October 3, 2000).

36. Sections 226.17-.18 of Regulation Z set forth the requirements for disclosures for closed-end credit, including but not limited to HOEPA loans. Pursuant to those provisions, lenders offering closed-end credit must provide written disclosures before consummation of the transaction that include the following information about the loan: the amount financed, the finance charge, the APR, and the total of payments. 12 C.F.R. § 226.17-.18.

37. The complaint alleged that higher broker fees were charged to African American females than to white males in violation of the ECOA and the Fair Housing Act, 42 U.S.C. §§ 3601-3619, and that few or no services were performed in exchange for certain broker charges in violation of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2607. See United States v. Delta Funding Corp. and Delta Financial Corp., Civ. Action No. 00 1872 (E.D.N.Y. April 2000).

38. See Federal Trade Commission, *Home Equity Lenders Settle Charges That They Engaged in Abusive Lending Practices; Over Half Million Dollars To Be Returned to Consumers*, Press Release, July 29, 1999.

39. See Consent Judgment and Order, F.T.C. v. Barry Cooper Properties, No. 99-07782 WDK (Ex) (C.D. Cal. July 30, 1999). The order provides that Cooper cannot offer or extend any HOEPA loans for the prescribed period of time unless he first obtains a $150,000 performance bond.

40. See supra note 38.

41. See Federal Trade Commission, *Sub-prime Lender Agrees to Settle FTC Charges of Violating Federal Lending and Consumer Protection Laws*, Press Release, July 18, 2000.

42. See F.T.C. v. Fleet Fin., Inc., C3899 (F.T.C. Oct. 5, 1999).

43. See Complaint, Capital City Mortgage, supra note 14.

44. See 15 U.S.C. § 1692.

45. See The Money Tree, 123 F.T.C. 1187 (1997).

46. See Tower Loan of Miss., 115 F.T.C. 140 (1992).

47. See, e.g., Matter of Commercial Credit Co., 82 F.T.C. 1841 (1973), order reopened and modified, 98 F.T.C. 783 (1981).

48. See Federal Trade Commission, *Sub-prime Lender Agrees to Pay $350,000 Civil Penalty to Settle Charges of Violating Federal Lending Laws*, Press Release, Aug. 24, 2000.

49. State Attorneys General also have authority to enforce HOEPA. See 15 U.S.C. § 1640 (e).

50. Additional housing-related brochures issued by the Commission include: *After a Disaster: Hiring a Contractor; Reverse Mortgages: Cashing in on Home Ownership*; and *Home Equity Loans: The Three Day Cancellation Rule*.