IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

NATIONAL ASSOCIATION OF INDEPENDENT HOUSING PROFESSIONALS, INC., 601 Pennsylvania Avenue, N.W. Suite 900 Washington, DC 20004, Plaintiff, v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 20th Street and Constitution Ave., N.W. Washington, DC 20551, Defendant.	)	C.A. No. ____________

COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF

OVERVIEW

1. This action challenges a final rule ("Final Rule") adopted by the Board of Governors of the Federal Reserve System ("Board") amending Regulation Z, which purports to implement the Truth in Lending Act ("TILA") and Home Ownership and Equity Protection Act, ("HOEPA") 15 U.S.C.§§ 1601, *et seq*., 75 Fed. Reg. 58,509-58,538 (Sept. 24, 2010) (to be codified at 12 C.F.R. part 226). The Final Rule prohibits payments to loan originators, which includes mortgage brokers and loan officers, based on the terms or conditions of the transaction, other than the amount of credit extended. The Final Rule also prohibits any person other than the

consumer from paying compensation to a loan originator in a transaction where the consumer pays the loan originator directly. Finally, the Final Rule prohibits loan originators from steering consumers to consummate loans not in their interest based on the fact that the loan originators will receive greater compensation for such loans. The Final Rule is scheduled to take effect on April 1, 2011. The Final Rule and the arbitrary interpretation placed upon it by the Board's staff will place mortgage brokers at a significant and permanent competitive disadvantage and will stifle competition in the mortgage lending industry to the detriment of consumers.

2. The Board adopted the Final Rule in violation of its statutory authority under the TILA, which has as its purpose "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." 15 U.S.C. § 1601(a). While the Board purports to rely upon its authority under "TILA Section § 129 (1) (2) (A) and (B) [15 U.S.C. § 1639 (l) (2) (A)-(B)] to prohibit acts or practices relating to mortgage loans that are unfair or deceptive and refinancings that are abusive and not in the interest of the borrower," 75 Fed. Reg. 58,509, the Board merely asserts that the long-standing lawful practice of permitting consumers to defray a portion of the closing costs associated with home mortgages, including loan originator compensation, through mortgage interest rate adjustment is "unfair" or "deceptive" as defined by Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 ("FTC Act") without citing any evidence to support that assertion. Instead, the Board states *ipse disit* that "paying loan originators based on the terms or conditions of the loan, other than the amount of credit extended, or steering consumers to loans that are not in their interest to maximize loan originator compensation, are unfair practices." 75 Fed. Reg. 58,514

3. The Final Rule is arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with law, and in excess of statutory jurisdiction, and authority, 5 U.S.C. § 706 (2) (a) and (c). The Final Rule was also adopted in contravention of the Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq*. ("RFA").

4. Enforcement of the Final Rule will cause irreparable harm to Plaintiff National Association of Independent Housing Professionals, Inc. ("NAIHP") and its members and is contrary to the public interest. The Final Rule treats loan originators differently from other providers of real estate settlement services such that loan originators and mortgage brokers in particular will be at a permanent disadvantage in the marketplace, thereby reducing healthy competition to the detriment of consumers.

JURISDICTION AND VENUE

5. The Court has jurisdiction of the matter pursuant to 28 U.S.C. § 1331. The action arises under the TILA, 15 U.S.C. §§ 1601 *et seq*., and the Declaratory Judgment Act, 28 U.S.C. §§ 2201 and 2202.

6. Plaintiff NAIHP is a for-profit trade corporation organized under the laws of Virginia, with its principal place of business in Washington, D.C. NAIHP is suing in its individual capacity and as a representative on behalf of its members.

7. Defendant Board is responsible for the operation of the Federal Reserve System and the promulgation of rules and regulations by the agency including the Final Rule at issue. The Board is sued in its official capacity only.

8. Venue in this Court is proper pursuant to 28 U.S.C. § 1391(b) and (e).

STANDING

9. At least one of NAIHP's members has standing to sue in its own right.

10. The interests NAIHP seeks to protect are germane to its purpose.

11. Neither the claim nor the relief requested requires the participation of the individual NAIHP members in the suit.

BACKGROUND

12. NAIHP represents the interests of thousands of independent housing professionals, including mortgage brokers and mortgage originators, located in all fifty states and the District of Columbia. NAIHP represents the interests of its members in legislative and regulatory matters. NAIHP also represents the interests of homebuyers and advocates for public policies that serve the mortgage consumer by promoting competition, facilitating homeownership and ensuring quality service.

13. While mortgage brokers, mortgage bankers and mortgage originators are financial professionals or entities that work with both consumers and lenders to obtain mortgage loans, they represent neither. They add value to both consumers and lenders by providing goods such as customer bases, goodwill, facilities and services. They also serve otherwise underserved communities.

14. Mortgage brokers work with consumers to help them through the complexities of home purchases by taking the applications; performing financial and credit evaluations; collecting and preparing documents; working with realtors; ordering title searches, appraisals, and pay-off letters; assisting in remedying faulty credit reports or title problems; and facilitating loan closings.

15. Mortgage brokers have helped millions of consumers, including many low-to-moderate-income borrowers, achieve homeownership and provide consumers with a highly efficient and cost effective means of obtaining a mortgage that fits the consumers' particular

financial goals and circumstances. They also are important in invigorating competition in the mortgage lending industry by expanding product choices, reducing marginal prices and serving new customers.

16. A major obstacle to homeownership is the upfront cost of obtaining a mortgage, a significant portion of which is closing costs and loan origination fees. For borrowers who cannot pay these fees out of pocket, or who seek a means of reducing or deferring closing costs, the yield spread premium ("YSP") affords prospective homebuyers such an option in a practical manner that facilitates home buying. The YSP is a payment made to a mortgage broker by a lender for the purchase of a broker-originated mortgage loan. The YSP represents the premium a lender is willing to pay to purchase a loan with an interest rate that is above the lender's "par rate."

17. A YSP allows borrowers to pay some or all settlement costs over the life of a mortgage loan through a higher interest rate. The Department of Housing and Urban Development ("HUD") has expressly approved YSPs as a way for borrowers assuming broker-originated mortgages to pay settlement costs, including compensation to their broker for loan origination services, because significant settlement costs would otherwise prove insurmountable obstacles for many would-be homebuyers.

18. Loan originators other than brokers may provide the same benefit to borrowers, *i.e.* no or reduced upfront settlement costs in exchange for a higher interest rate on the borrower's mortgage loan - but do not use YSPs. Those originators instead recoup the cost of deferring settlement costs by selling mortgage loans in the secondary market for a price that represents the difference between the interest rate on the lender-originated loan and the purchaser's "par rate." The present value of that difference in interest rates is called a service

release premium ("SRP"). HUD has explicitly recognized that the sale of lender-originated loans on the secondary market or SRP achieves the same purpose as lender payments to mortgage brokers, or YSPs; the payments are functionally equivalent.

19. Mortgage markets have evolved in recent years as have the roles of mortgage professionals and entities, who may work in multiple capacities. Today, loans, regardless of originator, are often repackaged, sold and securitized.

20. In today's loan origination marketplace, mortgage originators, who at one time may have been distinguishable from mortgage brokers, increasingly function as brokers. For example, lenders often know at the time of closing that they will quickly sell the loan and can calculate how much they will make from the sale of the loan. Lenders also often enter into multiple contracts with various banks and other lenders to offer an array of products, and they receive underwriting approval from another funding source prior to funding mortgage loans.

21. Since 1992, mortgage brokers, unlike any other participants in the residential real estate market, have been required to disclose fully all of their compensation, including the YSP, on a consumer's good faith estimate of settlement costs ("GFE") and also in the HUD-1 settlement statement. Significantly, the same type of early disclosure was and still is absent in bank and/or creditor retail transactions.

22. In addition, since 1996, mortgage brokers and non-bank loan originators have provided consumers with a simple and clear disclosure that details the nature of their relationship with consumers and creditors, as well as how such loan originators are compensated. The typical mortgage loan origination agreement states, for example, that the loan originators "are acting as an independent contractor and not as [the consumer's] agent," and that the loan originators "will enter into separate independent contractor agreements with various lenders." *See* Ex. 1

Mortgage Loan Origination Agreement. It also states explicitly that "[w]hile [the loan originator] seek[s] to assist you in meeting your financial needs, [they] do not distribute the products of all lenders or investors in the market and *cannot guarantee the lowest price or best terms available in the market. Id.* (emphasis added). With respect to loan originator compensation, the agreement is clear and unambiguous, noting that:

> The lenders whose loan products we distribute generally provide their loan products to us at a wholesale rate.
>
> - The retail price we offer you - your interest rate, total points and fees - will include our compensation.
> - In some cases, we may be paid all of our compensation by either you or the lender.
> - *Alternatively, we may be paid a portion of our compensation by both you and the lender.* For example, in some cases, if you would rather pay a lower interest rate, you may pay higher up-front points and fees.
> - Also, in some cases, if you would rather pay less up front, *you may be able to pay some or all of our compensation indirectly through a higher interest rate in which case we will be paid directly by the lender.*
>
> We also may be paid by the lender based on (i) the value of the mortgage loan or related servicing rights in the market place or (ii) other services, goods or facilities performed or provided by us to the lender.

Id. (emphasis added).

23. Beginning in 2006, the Board, purporting to act pursuant to Section 158 of HOEPA, TILA Section 129, conducted a series of hearings culminating in June 2007. Subsequently, in December 2007, the Board issued a proposed HOEPA rule that would "prohibit creditors from paying a mortgage broker more than the consumer had agreed in advance that the broker would receive." 73 Fed. Reg. 1,672, 1,698-1,700 (Jan. 9, 2008). At the time, the Board stated that it "shares concerns . . . that creditor payments to mortgage brokers are not transparent to consumers *and are potentially unfair to them*." 75 Fed. Reg. 58,511 (emphasis added).

24. On July 10, 2008, MACRO International submitted to the Board the results of consumer tests specifically examining broker payment disclosures. In the course of that test, MACRO International interviewed 35 participants in four rounds of interviews in three cities: one round each in Kansas City, Kansas, and Los Angeles, California, and two rounds in Washington, D.C.

25. On July 30, 2008, the Board published the HOEPA final rule implementing seven new restrictions or requirements for mortgage lending and servicing intended to protect consumers against unfairness, deception and abuse while preserving responsible lending and sustainable homeownership. On the basis of testing and "other information," the Board withdrew the January 2008 proposal to "prohibit creditors from paying a mortgage broker more than the consumer had agreed in advance that the broker would receive." In withdrawing the rule, the Board stated that "[t]he Board concluded . . . that substantial additional testing and analysis would be required to determine whether such an approach would be effective" and that it would "continue to consider whether disclosures or other approaches could effectively remedy this potential unfairness without imposing unintended consequences." 73 Fed. Reg. 44,522 44,563 (July 30, 2008).

26. On July 16, 2009, ICF MACRO (formerly MACRO International) submitted to the Board the results of thirteen rounds of testing covering four groups and 102 interviews from February 2008 through May 2009. The study, which focused on disclosures and shopping behavior, contained no questions that addressed loan originator compensation.

27. Thereafter, on August 26, 2009, the Board, with no publicly identified substantial additional testing or analysis regarding loan originator compensation, published a Notice of Proposed Rulemaking ("NOPR") that purported to add to or amend several aspects of Regulation

Z. Specifically, in addition to, *inter alia*, changes to disclosures, disclosure timing, and finance charge calculations, the proposed rule sought to prohibit various aspects of mortgage broker compensation. In support of the proposed rule, the Board cited its alleged authority under Section 129(l)(2) of the TILA, 15 U.S.C. § 1639 (l)(2), to proscribe, *inter alia*, practices found to be "unfair" or "deceptive" or designed to evade the HOEPA. The Board expressly acknowledged that in construing and applying those terms, it "has generally relied on the standards that have been adopted for purposes of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a) . . . ." 74 Fed. Reg. 43,281. Thus, without any apparent additional testing or analysis since withdrawing its earlier proposed rule addressing the alleged "potential unfairness" of certain aspects of loan originator compensation, (73 Fed. Reg. 44,522), the Board concluded that "potential unfairness" had become actual unfairness necessitating a ban on certain loan originator compensation.

28. In a prior policy statement, the Board stated that "in analyzing a particular act or practice, the agencies will be guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the courts and the FTC." Board of Governors, Federal Reserve System, "Unfair or Deceptive Acts or Practices by State Chartered Banks" (March 11, 2004). (Ex. 2)

29. In response to the August 26, 2009 NOPR, the Board stated that it received over 6,000 comments to the proposed rule. The vast majority of the comments opposed the proposed loan originator compensation changes.

30. On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), Pub. L. 111-203, 124 Stat. 1376, Title X of which establishes a new Consumer Financial Protection Bureau ("CFPB") with purview over

certain enumerated consumer laws that include, *inter alia*, the TILA and empowers the Director of the CFPB to "implement the Federal consumer financial laws," subject to the Director's authority as enumerated laws, "through rules, orders, guidance, interpretations and statements of policy, examinations and enforcement actions." Title X, Section 1012(a)(1) of the Dodd-Frank Act.

31. Title XIV, Subtitle A, Section 1403 of the Dodd-Frank Act amends Section 129B of the TILA by adding a new subsection C that, *inter alia*, "[f]or any mortgage loan, a mortgage originator may not receive from any person other than the consumer and no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator, or an affiliate or the creditor or mortgage originator."

32. Despite the foregoing prohibition, the Dodd-Frank Act expressly provides that "the Board may, by rule, waive or provide exemption to this [prohibition] if the Board determines that such waiver or exemption is in the interest of consumers and the public interest." Section 1403 of the Dodd-Frank Act (Section 129B(c)(B)(ii)). In addition, the Dodd-Frank Act also provides a safe harbor equal to 3% of the total amount for points and fees. Section 1412 of the Dodd-Frank Act. In the Dodd-Frank Act, Congress expressly provided a timetable for the Board to promulgate new regulations which is set to begin in July 2011. In the Dodd-Frank Act, Congress also sought to address comprehensively, *inter alia*, the issue of loan originator compensation and the interrelationship between the disclosure and substantive requirements of the TILA and the disclosure and substantive requirements of the Real Estate Settlement

Procedure Act ("RESPA"), 12 U.S.C. §§ 2601 *et seq.*, and to that end transferred the Board's authority over such matters to the CFPB.

33. Three weeks after the passage of the Dodd-Frank Act, the Board issued the Final Rule which addresses only the compensation proposal from the August 2009 proposed rule, despite the fact that the Dodd-Frank Act addresses the same issues the Board addresses in the rulemaking and transfers the Board's authority to implement such a rule to the CFPB. There are differences between the Board's Final Rule and the Dodd-Frank Act with respect to loan originator compensation.

34. In issuing the Final Rule, the Board stated that "the purpose of the final rule is to protect consumers in the mortgage market from unfair or abusive lending practices that can arise from certain loan originator compensation practices, while preserving responsible lending and sustainable homeownership." 75 Fed. Reg. 58,509.

35. In promulgating the Final Rule, the Board explicitly relies upon its alleged authority under TILA Sections 129 (l) (2) (A) and (B), 15 U.S.C. §§ 1639 (l) (2) (A) - (B), which, under settled Board authority, requires the Board to find the loan originator compensation to be unfair or deceptive.

36. In promulgating the Final Rule, the Board relied upon unsubstantiated allegations and supposition rather of empirical evidence supporting its finding that the current long-standing practice of compensating loan originators is unfair, deceptive or abusive.

37. The Board's conclusion that the alleged harm of the current long-standing loan originator compensation system cannot be remedied by disclosures and that current disclosures leave consumers confused about how the loan originator is compensated and the nature of the relationship between the consumer and the loan originator is based on a study involving only 35

participants. The study actually contradicts the Board's conclusion that disclosures are ineffective.

38. There is no practical difference between a YSP and the service release premium ("SRP") that a bank, which originates a loan, receives when it sells that loan into the secondary market. The Board, however, excludes banks from the requirements of the Final Rule. Hence, banks are free to charge consumers interest rates higher than their par rates with impunity and receive compensation from both the consumer and the purchaser in the secondary market.

39. The Final Rule will have the effect of limiting the compensation of loan originators who are independent mortgage brokers and those who are employed by banks while leaving the banks free to charge with impunity interest rates substantially above their par rate.

40. By eliminating banks from the requirements of the Final Rule, the Board will in fact exempt from consumer protection the vast majority of the mortgage origination market despite its stated "purpose . . .. to protect consumers in the mortgage market from unfair or abusive lending practices that can arise from certain loan originator compensation practices, while preserving responsible lending and sustainable homeownership." 75 Fed. Reg. 58,509.

41. Among the arbitrary and capricious interpretations of the Final Rule contained in the Staff Comments are provisions that are in direct conflict with the requirements of RESPA and that effectively prevent mortgage brokers from competing for business in certain instances and force brokers to choose which regulations to violate in other instances.

42. The Board has failed to comply with the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612. The Office of Advocacy of the Small Business Administration ("SBA") has noted that "the Board acknowledges that the proposed rule will have a significant economic impact on a substantial number of small entities" and concedes that "there is not a reliable source for the

number of small entities that will be impacted." Instead, rather than undertake any type of impact analysis, the Board summarily concludes that any such adverse impact will be offset by consumer benefits.

43. Although the Board dismissed the substantial burden that the Final Rule places on small businesses, the SBA Advocacy Office has stated that it is "concerned with [the Final Rule] going forward when so little is known about its potential costs, at a time when other major changes to the industry are on the horizon."

44. Inasmuch as the Board has admitted that the Final Rule will have a "significant economic impact on small entities," such as mortgage brokers and the impending congressionally mandated broad regulatory review of the conflicting requirements of RESPA and TILA in connection with the implementation of the Dodd-Frank Act, the Board's insistence upon going forward with the Final Rule in light of its recent decision to defer proceeding with other provisions of TILA currently under consideration is arbitrary and capricious.

LEGAL BASES FOR CHALLENGING THE BOARD'S FINAL RULE

45. The Final Rule exceeds the scope of the Board's authority to interpret and promulgate regulations under 15 U.S.C. §§ 1639 (l) (2) and is thus invalid pursuant to 5 U.S.C. § 706(2)(c).

46. The Final Rule is not reasonably supported by the Board's explanations and justifications, and the Board has failed to offer any rational basis for its rejection of alternative approaches to achieving the asserted goals of the Final Rule, including alternatives proposed by the SBA Office of Advocacy. The Final Rule is arbitrary and capricious, an abuse of discretion, and otherwise not in accordance with law. Consequently, the Final Rule is invalid pursuant to 5 U.S.C. § 706(2)(a).

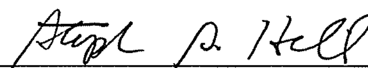
47. The Final Rule is void, invalid, and unenforceable because the Board promulgated it in violation of the Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq*, in that it failed to do a proper analysis of the impact of the Final Rule on small businesses and entities such as NAIHP's members and failed to consider alternatives suggested by, *inter alia*, the SBA Office of Advocacy and relied instead upon flawed consumer testing the results of which did not support the Board's conclusion with respect to the appropriateness of disclosure.

48. NAIHP and its members do not have an adequate remedy at law.

49. NAIHP and its members will suffer irreparable harm if the Board is not enjoined from enforcing the Rule, which is scheduled to take effect on April 1, 2011.

WHEREFORE, Plaintiff NAIHP prays that the Court issue a declaratory judgment that the Final Rule is contrary to law, arbitrary and capricious, unenforceable, and otherwise unlawful and that the Court grant permanent injunctive relief enjoining Defendant Board from enforcing the Final Rule, with costs and attorneys fees against Defendant Board.

Respectfully submitted,



Stephen S. Hill (927137)
HOWREY LLP
1299 Pennsylvania Ave., N.W.
Washington, D.C. 20004
(202) 783-0800 - Tel.
(202) 383-6610 - Fax
hillstephen@howrey.com

Attorney for Plaintiff

Dated: March 7, 2011

EXHIBIT 1

MORTGAGE LOAN ORIGINATION AGREEMENT

(Warning to Broker: The content of this form may vary depending upon the state in which it is used.)

You agree to enter into this Mortgage Loan Origination Agreement with as an independent contractor to apply for a residential mortgage loan from a participating lender with which we from time to time contract upon such terms and conditions as you may request or a lender may require. You inquired into mortgage financing with on

We are licensed as a "Mortgage Broker" under

SECTION 1. NATURE OF RELATIONSHIP. In connection with this mortgage loan:

* We are acting as an independent contractor and not as your agent.
* We will enter into separate independent contractor agreements with various lenders.
* While we seek to assist you in meeting your financial needs, we do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.

SECTION 2. OUR COMPENSATION. The lenders whose loan products we distribute generally provide their loan products to us at a wholesale rate.

* The retail price we offer you - your interest rate, total points and fees - will include our compensation.
* In some cases, we may be paid all of our compensation by either you or the lender.
* Alternatively, we may be paid a portion of our compensation by both you and the lender. For example, in some cases, if you would rather pay a lower interest rate, you may pay higher up-front points and fees.
* Also, in some cases, if you would rather pay less up front, you may be able to pay some or all of our compensation indirectly through a higher interest rate in which case we will be paid directly by the lender.

We also may be paid by the lender based on (i) the value of the Mortgage Loan or related servicing rights in the market place or (ii) other services, goods or facilities performed or provided by us to the lender.

By signing below, the mortgage loan originator and mortgage loan applicant(s) acknowledge receipt of a copy of this signed Agreement.

MORTGAGE LOAN ORIGINATOR		APPLICANT(S)	
Company Name		Applicant Name(s)	
Address		Address	
City, State, Zip		City, State, Zip	
Phone/Fax		Borrower Signature	Date
Broker or Authorized Agent Signature	Date	Co-Borrower Signature	Date

EXHIBIT 2

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

Unfair or Deceptive Acts or Practices by State-Chartered Banks

March 11, 2004

Purpose

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (the "Board" and the "FDIC," or collectively, the "Agencies") are issuing this statement to outline the standards that will be considered by the Agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices found in section 5 of the Federal Trade Commission Act ("FTC Act")[1] as they apply to acts and practices of state-chartered banks. The Agencies will apply these standards when weighing the need to take supervisory and enforcement actions and when seeking to ensure that unfair or deceptive practices do not recur.

This statement also contains a section on managing risks relating to unfair or deceptive acts or practices, which includes best practices as well as general guidance on measures that state-chartered banks can take to avoid engaging in such acts or practices.

Although the majority of insured banks adhere to a high level of professional conduct, banks must remain vigilant against possible unfair or deceptive acts or practices both to protect consumers and to minimize their own risks.

Coordination of Enforcement Efforts

Section 5(a) of the FTC Act prohibits "unfair or deceptive acts or practices in or affecting commerce,"[2] and applies to all persons engaged in commerce, including banks. The Agencies each have affirmed their authority under section 8 of the Federal Deposit Insurance Act to take appropriate action when unfair or deceptive acts or practices are discovered.[3]

---

[1] 15 U.S.C. § 45.

[2] 15 U.S.C. § 45(a).

[3] 12 U.S.C. § 1818(b)(1), (e)(1), and (i)(2). See letter from Chairman Greenspan to the Hon. John J. LaFalce (May 30, 2002); and "Unfair or Deceptive Acts or Practices: Applicability of the Federal Trade Commission Act," FIL 57-2002 (May 30, 2002).

A number of agencies have authority to combat unfair or deceptive acts or practices. For example, the FTC has broad authority to enforce the requirements of section 5 of the FTC Act against many non-bank entities.[4] In addition, state authorities have primary responsibility for enforcing state statutes against unfair or deceptive acts or practices. The Agencies intend to work with these other regulators as appropriate in investigating and responding to allegations of unfair or deceptive acts or practices that involve state banks and other entities supervised by the Agencies.

Standards for Determining What is Unfair or Deceptive

The FTC Act prohibits unfair or deceptive acts or practices. Congress drafted this provision broadly in order to provide sufficient flexibility in the law to address changes in the market and unfair or deceptive practices that may emerge.[5]

An act or practice may be found to be *unfair* where it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition."[6] A representation, omission, or practice is *deceptive* if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer's conduct or decision regarding a product or service.

The standards for unfairness and deception are independent of each other. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is *either* unfair *or* deceptive. Whether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances. In analyzing a particular act or practice, the Agencies will be guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the courts and the FTC. The Agencies will also consider factually similar cases brought by the FTC and other agencies to ensure that these standards are applied consistently.

Unfair Acts or Practices

Assessing whether an act or practice is unfair

An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

---

[4] 15 U.S.C. § 45(a)(2) and Gramm-Leach-Bliley Act § 133, published in notes to 15 U.S.C. § 41.

[5] See FTC Policy Statement on Unfairness (December 17, 1980); and FTC Policy Statement on Deception (October 14, 1983).

[6] This standard was first issued as a policy by the FTC and later codified into the FTC Act as 15 U.S.C. § 45(n).

- *The act or practice must cause or be likely to cause substantial injury to consumers.*

To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.

- *Consumers must not reasonably be able to avoid the injury.*

A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

The Agencies will not second-guess the wisdom of particular consumer decisions. Instead, the Agencies will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.

- *The injury must not be outweighed by countervailing benefits to consumers or to competition.*

To be unfair, the act or practice must be injurious in its net effects —that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.

- *Public policy may be considered.*

Public policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute

may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

Deceptive Acts and Practices

Assessing whether an act or practice is deceptive

A three-part test is used to determine whether a representation, omission, or practice is "deceptive." First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- *There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.*

An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The Agencies will evaluate it in the context of the entire advertisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include: making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

- *The act or practice must be considered from the perspective of the reasonable consumer.*

In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.

If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer's interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer's interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

In evaluating whether a representation, omission or practice is deceptive, the Agencies will look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

- *The representation, omission, or practice must be material.*

A representation, omission, or practice is material if it is likely to affect a consumer's decision regarding a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. Similarly, the materiality of an implied claim will be presumed when it is demonstrated that the institution intended that the consumer draw certain conclusions based upon the claim.

Claims made with the knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

Relationship to Other Laws

Acts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act may also violate other federal or state statutes. On the other hand, there may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. Banks should be mindful of both possibilities. The following laws warrant particular attention in this regard:

Truth in Lending and Truth in Savings Acts

Pursuant to the Truth in Lending Act (TILA), creditors must "clearly and conspicuously" disclose the costs and terms of credit.[7] The Truth in Savings Act (TISA) requires depository institutions to provide interest and fee disclosures for deposit accounts so that

[7] 15 U.S.C. § 1632(a).

consumers may compare deposit products.[8] TISA also provides that advertisements shall not be misleading or inaccurate, and cannot misrepresent an institution's deposit contract. An act or practice that does not comply with these provisions of TILA or TISA may also violate the FTC Act. On the other hand, a transaction that is in technical compliance with TILA or TISA may nevertheless violate the FTC Act. For example, consumers could be misled by advertisements of "guaranteed" or "lifetime" interest rates when the creditor or depository institution intends to change the rates, whether or not the disclosures satisfy the technical requirements of TILA or TISA.

Equal Credit Opportunity and Fair Housing Acts

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction against persons on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Similarly, the Fair Housing Act (FHA) prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. Unfair or deceptive practices that target or have a disparate impact on consumers who are members of these protected classes may violate the ECOA or the FHA, as well as the FTC Act.

Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although this statute does not by its terms apply to banks that collect their own debts, failure to adhere to the standards set by this Act may support a claim of unfair or deceptive practices in violation of the FTC Act. Moreover, banks that either affirmatively or through lack of oversight, permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for approving or assisting in an unfair or deceptive act or practice.

Managing Risks Related to Unfair or Deceptive Acts or Practices

Since the release of the FDIC's statement and the Board's letter on unfair and deceptive practices in May 2002, bankers have asked for guidance on strategies for managing risk in this area. This section outlines guidance on best practices to address some areas with the greatest potential for unfair or deceptive acts and practices, including: advertising and solicitation; servicing and collections; and the management and monitoring of employees and third-party service providers. Banks also should monitor compliance with their own policies in these areas, and should have procedures for receiving and addressing consumer complaints and monitoring activities performed by third parties on behalf of the bank.

[8] 12 U.S.C. § 4301 *et seq.*

To avoid engaging in unfair or deceptive activity, the Agencies encourage use of the following practices, which have already been adopted by many institutions:

Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.

Draw the attention of customers to key terms, including limitations and conditions, that are important in enabling the customer to make an informed decision regarding whether the product or service meets the customer's needs.

Clearly disclose all material limitations or conditions on the terms or availability of products or services, such as a limitation that applies a special interest rate only to balance transfers; the expiration date for terms that apply only during an introductory period; material prerequisites for obtaining particular products, services or terms (e.g., minimum transaction amounts, introductory or other fees, or other qualifications); or conditions for canceling a service without charge when the service is offered on a free trial basis.

Inform consumers in a clear and timely manner about any fees, penalties, or other charges (including charges for any force-placed products) that have been imposed, and the reasons for their imposition.

Clearly inform customers of contract provisions that permit a change in the terms and conditions of an agreement.

When using terms such as "pre-approved" or "guaranteed," clearly disclose any limitations, conditions, or restrictions on the offer.

Clearly inform consumers when the account terms approved by the bank for the consumer are less favorable than the advertised terms or terms previously disclosed.

Tailor advertisements, promotional materials, disclosures and scripts to take account of the sophistication and experience of the target audience. Do not make claims, representations or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.

Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend or is not able to provide the service to accountholders.

Clearly disclose when optional products and services — such as insurance, travel services, credit protection, and consumer report update services that are offered simultaneously with credit — are not required to obtain credit or considered in decisions to grant credit.

Ensure that costs and benefits of optional or related products and services are not misrepresented or presented in an incomplete manner.

When making claims about amounts of credit available to consumers, accurately and completely represent the amount of potential, approved, or useable credit that the consumer will receive.

Avoid advertising terms that are not available to most customers and using unrepresentative examples in advertising, marketing, and promotional materials.

Avoid making representations to consumers that they may pay less than the minimum amount due required by the account terms without adequately disclosing any late fees, overlimit fees, or other account fees that will result from the consumer paying such reduced amount.

Clearly disclose a telephone number or mailing address (and, as an addition, an email or website address if available) that consumers may use to contact the bank or its third-party servicers regarding any complaints they may have, and maintain appropriate procedures for resolving complaints. Consumer complaints should also be reviewed by banks to identify practices that have the potential to be misleading to customers.

Implement and maintain effective risk and supervisory controls to select and manage third-party servicers.

Ensure that employees and third parties who market or promote bank products, or service loans, are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.

Review compensation arrangements for bank employees as well as third-party vendors and servicers to ensure that they do not create unintended incentives to engage in unfair or deceptive practices.

Ensure that the institution and its third party servicers have and follow procedures to credit consumer payments in a timely manner. Consumers should be clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.

The need for clear and accurate disclosures that are sensitive to the sophistication of the target audience is heightened for products and services that have been associated with abusive practices. Accordingly, banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who

are not financially sophisticated. In addition, creditors should pay particular attention to ensure that disclosures are clear and accurate with respect to: the points and other charges that will be financed as part of home-secured loans; the terms and conditions related to insurance offered in connection with loans; loans covered by the Home Ownership and Equity Protection Act; reverse mortgages; credit cards designed to rehabilitate the credit position of the cardholder; and loans with pre-payment penalties, temporary introductory terms, or terms that are not available as advertised to all consumers.

Conclusion

The development and implementation of policies and procedures in these areas and the other steps outlined above will help banks assure that products and services are provided in a manner that is fair, allows informed customer choice, and is consistent with the FTC Act.

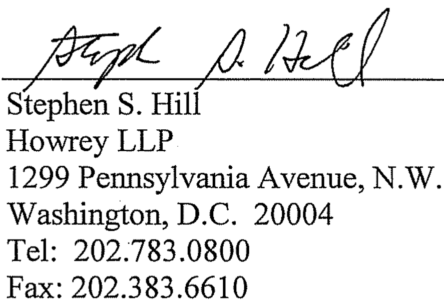
CERTIFICATE OF SERVICE

I hereby certify that I caused true copies of the foregoing Complaint for Declaratory and Injunctive Relief to be served by hand, this 7th day of March, 2011 upon each of the person listed below:

United States Attorney Robert C. Machen, Jr.
United States Attorney's Office
For the District of Columbia
555 4th Street, N.W.
Washington, D.C. 20530

Assistant Attorney General Tony West
Department of Justice
Civil Division
950 Pennsylvania Avenue, N.W.
Room B-103
Washington, D.C. 20530

Board of Governors
Federal Reserve System
Office of the Secretary
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551



Stephen S. Hill
Howrey LLP
1299 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
Tel: 202.783.0800
Fax: 202.383.6610

Counsel for Plaintiff National Association of Independent Housing Professionals