

**THE ECONOMY AND FRAUD:  
PROTECTING CONSUMERS DURING  
DOWNWARD ECONOMIC TIMES**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION,  
PRODUCT SAFETY, AND INSURANCE

OF THE

COMMITTEE ON COMMERCE,  
SCIENCE, AND TRANSPORTATION  
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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JULY 14, 2009  
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SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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**THE ECONOMY AND FRAUD:  
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**TUESDAY, JULY 14, 2009**

U.S. SENATE,  
SUBCOMMITTEE ON CONSUMER PROTECTION, PRODUCT  
SAFETY, AND INSURANCE,  
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10:05 a.m. in room SR-253, Russell Senate Office Building, Hon. Mark Pryor, Chairman of the Subcommittee, presiding.

**OPENING STATEMENT OF HON. MARK PRYOR,  
U.S. SENATOR FROM ARKANSAS**

Senator PRYOR. I call this hearing of the Consumer Protection, Product Safety, and Insurance Subcommittee of the Senate Committee on Commerce, Science, and Transportation to order.

I want to welcome all of our witnesses today and thank you all for your testimony and your efforts in being here today.

We're here to receive testimony on the trends in consumer frauds and scams related to the recession. This hearing will examine a variety of frauds that are exploiting the financial hardships of consumers during the current economic downturn. We'll further explore what the FTC is, or should be doing, to protect and insulate consumers from these trends.

For the last several financial quarters, I've noticed an increase in the press reports on organized consumer fraud scams as the recession has deepened. And on July 1, 2009, the Federal Trade Commission announced a crackdown on scams playing on consumer fears about the economy. It's called "Operation Shortchange." And the FTC has initiated 15 actions to stop consumer fraud, such as Get Rich Quick and Easy Debt Relief schemes. The FTC partnered with the Department of Justice, which initiated 44 actions, 13 states and the District of Columbia.

Clearly, consumers are at risk of being swindled during this time, and they absolutely cannot afford to be bilked out of their savings and make disastrous financial decisions due to deceptive practices and fraud.

Our staff today has put together a great panel. We have the Attorney General of the State of Missouri, Chris Koster. And Chris is one of the great leaders in consumer protection from around the

country. And, General Koster, it's great to have you here today, and thank you.

We also have David Vladeck, who's the Director of the Bureau of Consumer Protection in the Federal Trade Commission. We have Chuck Bell, who's the Director of Programs at Consumers Union. We have Sally Greenberg, who is the Executive Director of National Consumers League, and Tim Muris, the Foundation Professor at George Mason University, former FTC Chairman. It's great to have you all here.

What we're going to do is, we're going to do brief opening statements. We know at least one of our Senators has to race back to the Judiciary Committee here momentarily. And then we'll ask the panel for their opening statements. And we're going to keep ours to 5 minutes or less, and then we will get right to the panel, and we'd ask the panel to keep theirs to 5 minutes, if possible.

Senator Nelson, do you have an opening statement?

And, by the way, Senator Wicker is on the way, and should be here shortly, and he would like to make an opening statement.

Senator McCaskill?

Senator McCASKILL. I will just wait and ask questions.

Senator PRYOR. Questions, great.

Senator McCASKILL. Thank you, Mr. Chairman.

Senator PRYOR. Senator Klobuchar, I know you need to run back to the Judiciary Committee. Would you like to make an opening statement?

**STATEMENT OF HON. AMY KLOBUCHAR,  
U.S. SENATOR FROM MINNESOTA**

Senator KLOBUCHAR. Well, yes, I would. And thank you so much, Mr. Chairman, for holding this important hearing at this difficult economic time. When I was a prosecutor, something that a number of us have done up here, one of the things that I would always notice was, when the economic times were tough, you'd see more and more scam artists. The other interesting part was, sometimes people would have been committing scams for years, but it was only when the economy went down that it was discovered because people started looking at their bank accounts or they couldn't make mortgage payments. So, you actually have this double whammy of people starting to commit more fraud, and then you also have fraud being discovered that maybe had been going on for years. So, I think it's very important that we focus on this.

I did want to start out, Mr. Vladeck, by commending the FTC for the work that you've done in a case that has been brought in Minnesota involving a violation of antitrust laws with a drug company that actually came out of Minnesota. In this case, the prices for a little baby's heart drug were jacked up 18 times simply because the company could and because they had the patent for the competing drug. It was an outrageous case. And at a hearing just like this, I held up a little vial and said to the now-Chairman of the FTC, "Well, what should we do about this?" I'm brand new at this job, and it just seems outrageous. And within a few months, the FTC brought a major fraud action in Federal court in Minnesota. So, I did want to mention that we're very appreciative of those efforts.

Also, the panel here talks about fraud efforts, I hope you'll focus some on, of course, the mortgage fraud issue and anything else that can be done. I know the Administration has a proposal to set up a special consumer agency to deal with some of the fraud with financial documents. And, while I may not be able to stay for questions, I'll submit those for the record and would like the panel's reaction to that.

I've done a bill that Representative Ellison is carrying in the House that's very much based on the Minnesota model, what's worked with mortgage fraud, which is called the Fairness for Homeowners Act. And I hope you'll look at that, as well.

So, mostly I hope to stay as long as I can. We do have that other little hearing going on in the other building. But, I want to thank you for your efforts. I think now is the time, more than any, that we have to make sure we're enforcing these laws because people are really suffering out there, and predators prey on them when there's not enough money to go around.

Thank you very much.

Senator PRYOR. Thank you, Senator Klobuchar. We will be joined shortly by at least a couple of other colleagues, it looks like, and maybe even more than that, depending on who's able to get away from their other committee obligations.

What I'd like to do now is go through the panel. I'm going to take it a little bit out of order. Since we have a statewide elected official here, I wanted to recognize General Koster first and give him 5 minutes to make his opening, and then I'll come back to you, Mr. Vladeck, and go down the line.

General?

**STATEMENT OF HON. CHRIS KOSTER, ATTORNEY GENERAL,  
STATE OF MISSOURI**

Mr. KOSTER. Thank you, Mr. Chairman and Members of the Committee.

I'll focus my comments today on what we are seeing in Missouri of particular interest and threats to our citizens. And the threat is this. Companies and individuals who specialize in servicing or preying upon consumers who have a significant credit card debt or unsustainable mortgage are running amuck in our state.

Foreclosure consultants and debt settlement firms claim to consumers that they can cut principal in half, reduce monthly payments by hundreds of dollars, or eliminate debt altogether. And they claim that this process can be virtually pain free. All that's required of a consumer is a few thousand dollars in up-front fees so that the companies may utilize their special expertise. Consumers in our state are led to believe these settlement companies know the secrets of negotiating away a consumer's debt.

Unfortunately, the real secret here is that these companies are offering services that consumers can largely do for themselves or that nonprofit counselors will perform free or for a modest fee. Moreover, one of the primary strategies relied upon by these debt settlement and mortgage companies is to convince consumers to stop payments altogether and to stop communications with his or her creditors, which, of course, leads to long-term damage to the consumer's credit rating and hundreds, if not thousands, of dollars

in additional debt and fees. In the end, to the extent these companies provide any service at all, debt settlement and mortgage modification companies often offer a service that leaves consumers no better off than where the consumer started. Real people are being harmed by these companies.

In Missouri, our complaint unit has seen a sharp increase in the volume of complaints related to foreclosure rescue scams. In 2007 and 2008 combined, our office had a total of 25 complaints. However, in just the first 6 months of 2009, we've already received more than three times as many complaints as we saw in 2007 and 2008 combined. For debt settlement complaints, there has been a similar spike.

Consumers are being lured by these debt settlement companies and foreclosure consultants by outrageously deceptive advertising techniques, including techniques that seek to co-op the authority of the Federal Government. Tens of thousands of direct-mail pieces are being distributed that purport to distribute money from the Economic Stimulus Act of 2008. These advertisements typically are replete with federal seals from the Housing and Urban Development or the Federal Housing Administration and logos that generally appear to be from the Federal Government. Eagles and flags abound on these advertisements. Unfortunately, too many consumers are being fooled by this, and those that are fooled are in the most desperate financial straits.

Where do we go from here? I would raise for your committee's consideration the following ideas.

First, most attorney generals would, I believe, support a federal ban on up-front fees related to mortgage rescue and debt settlement firms. In Missouri, we've seen so many examples of settlement companies that either never earn the fees that they charge up front or simply pocket the up-front fee and disappear altogether.

Second, do not shy away from applying the same up-front fee restrictions to lawyers and law firms who specialize in debt settlement work, although a caveat may need to be drawn around certain bankruptcy court practices. What is good for the goose is ultimately good for the gander.

Third, I would continue to provide the FTC with additional tools against settlement companies that claim the imprimatur of the Federal Government. The use of government symbols and logos in ads, the strong inference that these solicitations are coming from HUD or from the Federal Housing Administration, or the claim that the solicitation has been sent directly as a result of the Economic Stimulus Act, should be stopped. These advertisements are gross deceptions and should be punished as such.

Finally, continue to restrict advertisements and solicitations around reverse mortgages, and particularly sale-leaseback arrangements. In Missouri, advertisements for these products are increasingly frequent and increasingly bold.

I encourage the Committee to consider bright-line enforcement measures. And I thank you for your time today.

[The prepared statement of Mr. Koster follows:]



PREPARED STATEMENT OF HON. CHRIS KOSTER,  
ATTORNEY GENERAL, STATE OF MISSOURI

Thank you, Mr. Chairman,

I appreciate your bringing attention to the problems we are seeing across the Nation from scams and fraudulent activities borne directly from the recession. I will focus my comments today on what we in Missouri see as a particular threat to people impacted by the economic downturn—companies and individuals who specialize in servicing, some might say preying on, consumers who have significant credit card debt, and/or an unsustainable mortgage.

Foreclosure Consultants and Debt Settlement Firms offer to cut principal in half, reduce monthly payments by hundreds of dollars, or eliminate debt altogether. And, they claim the process is virtually pain free.

All that is required is a few thousand dollars in up-front fees so they may utilize their “expertise” to “help” the consumer—as they supposedly know the “secrets” to negotiating with the credit card companies.

The unmentioned secret is that these companies are offering a service that the consumer could do for himself; or that non-profit credit counselors will perform for free or a modest fee.

And these companies’ strategies rely on the consumer stopping all payments to and communications with his or her creditors.

It is this final aspect that leads to long-term damage to the consumer’s credit rating and hundreds or thousands of dollars in additional fees. In fact, to the extent that these companies provide the service at all, they often obtain a debt settlement or mortgage modification that is no better than where the consumer started, partly because of these additional fees and interest.

Real people are being harmed by these companies. The Complaint Unit in my office has seen a sharply increasing volume of complaints regarding *foreclosure rescue* scams: from 16 complaints in 2007 to 9 complaints in 2008 to 84 complaints thus far in 2009.

For *debt settlement*, there has been a similar spike: from 78 complaints in 2007 to 109 complaints in 2008 to 105 complaints thus far in 2009.

To further complicate matters, both debt settlement firms and foreclosure consultants are using deceptive advertising. Much of what we are seeing seeks to co-opt the authority of the Federal Government and these advertisements are ubiquitous.

Thousands of direct mail pieces are distributed every day across the country offering debt settlement or foreclosure relief purporting to use money from the “Economic Stimulus Act of 2008 [or 2009].” The references are to Federal programs that have nothing to do with the consumer targeted—for example, the Economic Stimulus Act of 2008 increased the size of loans that the Federal Housing Administration could insure; but this adjustment had nothing to do with whether a person with a \$150,000 loan could refinance.

The advertisements typically are replete with Federal seals from the Department of Housing and Urban Development and the Federal Housing Administration, and logos that generally appear to be from the Federal Government. Eagles and flags grace these advertisements.

In fact, I personally received an offer for enrollment in a “Payment Reduction Program” that was “created in conjunction with the Government Economic Stimulus Act of 2008.” The advertisement looked like it came from the Federal Government in that it was a “Form 008-S” and the subject line read “H.R. 5140 Government Economic Stimulus Act of 2008.”

Luckily my University of Missouri law school education taught me to examine the fine print, which was located at the far bottom of the letter and revealed the letter to be an “advertisement” and that the offer was not “being made by any agency of the government.”

Unfortunately, too many consumers are fooled by these tactics.

We could afford to be more tolerant of these schemes if they didn’t prey on those with so few resources.

Missouri takes seriously enforcement of laws that were enacted to address these issues: the Missouri Merchandising Practices Act, the Missouri Foreclosure Consultant Act, and the Missouri Credit Services Organization Act. Our state’s ban on up-front fees for foreclosure consultants and credit repair firms represents a particularly effective enforcement tool.

Missouri polices all manner of fraud, but financial fraud has become a priority, and for which Missouri has Zero Tolerance.

Missouri has a foreclosure consultant statute that, among other things, makes it illegal for a foreclosure consultant to take an up-front fee. This ban has been the most effective tool in fighting unscrupulous foreclosure consultants.

These services are often only profitable if the company charges a large up-front fee. A ban on such fees not only discourages companies with suspect motives from entering the market, but makes proving the enforcement action quite easy, thereby enabling swift injunctive relief.

In addition to several ongoing investigations, the Attorney General's office recently filed the following case:

*Gateway Mortgage Modifications, LLC*: The Attorney General's Office filed suit May 26, 2009, against this company for charging up-front fees for foreclosure relief and mortgage modifications. In addition, Gateway did not deliver the services promised, falling short on the promised interest rate reduction for mortgage modifications it did obtain (in violation of the Merchandising Practices Act). Gateway had about 200 clients at the time the suit was filed. A preliminary injunction has been agreed to and Missouri is seeking restitution for consumers and possible civil penalties.

Missouri also has a credit services organization statute that makes it illegal for such individuals to accept an up-front fee. Again, this is an effective way to police the credit repair markets because it discourages bad actors from entering the market and is an easily proven violation.

However, Missouri is also pursuing a deceptive and unfair practices theory under the Merchandising Practices Act with respect to debt settlement firms' advertisements and instruction to consumers not to pay their creditors while the company negotiates with those creditors.

In addition to several ongoing investigations, the Attorney General's Office recently filed the following case:

*Credit Solutions of America, Inc.* On May 28, 2009, Missouri filed suit against Credit Solutions of America, Inc. for violations of the Missouri Merchandising Practices Act and the Missouri Credit Services Organization Act. Credit Solutions claims it can lower consumers' monthly payment, resolve debts for 50 cents on the dollar, and get consumers out of debt within 3 years. In addition, Credit Solutions relies on consumers not paying their creditors during the negotiation. Finally, Credit Solutions failed to comply with several portions of the Credit Services Organization Act, including the ban on up-front fees. Missouri joins New York and Texas in filing suit against Credit Solutions for similar practices.

Missouri has used its Merchandising Practices Act to crack down on the deceptive use of Federal Government logos and programs. Missouri has also targeted companies making misleading references to consumers' lenders. Missouri has investigated more than a dozen companies, reached settlement with several, and brought two cases:

- *Goldstar Home Mortgage*: The Attorney General's Office filed suit April 20, 2009 against this company, which sent direct-mail letters to consumers with the consumers' own bank name at the top of the letter, making it appear that the consumers' bank was encouraging them to refinance.
- *Oxford Lending Group*: The Attorney General's Office filed suit April 20, 2009 against this company, which made deceptive representations regarding the "Economic Stimulus Act of 2008" in its mailing, to appear that consumers had a special opportunity to refinance, and using the HUD (U.S. Department of Housing and Urban Development) label and name to mislead the recipient that the letter was related to the Federal Government.

But, the most powerful tool to combat the appeal of the schemes is education.

The consumer complaint hotline, along with the Attorney General's website, is where Missouri consumers can let my office know about unscrupulous practices. In addition to a mediation procedure whereby investigators seek to resolve individual complaints, the complaint hotline allows Missouri to stay on the leading edge of what scams are out there and address them quickly.

Similarly, the Consumer Corner Blog on the Attorney General's website allows the Attorney General's consumer protection division to alert consumers as to what scams are out there and what they can do about them.

My website provides links that allow consumers to sign up for the no call list, which precludes most telemarketers from calling the consumer. This can prevent some scammers from ever pitching their product. The Missouri No Call List is a model for other states.

Further, my website has, on its front page, an Action Center, which has shortcut buttons for several categories of complaints, including Mortgage Fraud, Consumer Complaints, No Call, and Search of Complaints against Businesses. These

buttons reflect some of the priorities of the Missouri Attorney General's office in fighting scams; in fact, the buttons placed in the action center reflect what Missourians are telling the Attorney General regarding priorities for enforcement.

In addition, consumers can search businesses on my website to see whether those businesses have received any consumer complaints. We also publicize scams with the news media, in an attempt to get out the warnings as broadly as possible.

Finally, particularly given the foreclosure crisis, consumers need to know what help is available for free. For those in a distress position, the Federal Government has a website, [www.makinghomeaffordable.gov](http://www.makinghomeaffordable.gov), which can answer questions regarding refinancing or loan modifications. And, the Better Business Bureau or my office may be able to help direct the consumer to legitimate organizations that can help them with mounting debt or an adjusting mortgage.

In my 6 months as Missouri's Attorney General, I have been continually amazed at the lengths individuals will go in an attempt to scam innocent people out of their money. I am certain it has always been so; I saw it in my 10 years as a county prosecutor. But these tough economic times, with desperate consumers needing help and an array of new government programs, seem the perfect climate for frauds and scams to thrive. False hope is notoriously easy to provide.

I encourage your committee to consider any additional enforcement measures at the Federal level to make people using these fraudulent tactics think twice, and to give us as strong of tools as possible to go after them once they have perpetrated their scams. Thank you for your time.

Senator PRYOR. Thank you, General.

Next, we'll have David Vladeck, Director of Bureau of Consumer Protection, Federal Trade Commission.

Mr. Vladeck?

**STATEMENT OF DAVID VLADECK, DIRECTOR, BUREAU OF  
CONSUMER PROTECTION, FEDERAL TRADE COMMISSION**

Mr. VLADECK. Good morning, Chairman Pryor, Ranking Member Wicker, and Members of the Subcommittee. I'm David Vladeck. I'm the new Director of the Bureau of Consumer Protection at the Federal Trade Commission. I appreciate the opportunity to appear before you this morning.

We are doing what we can to protect consumers from fraud during this economic downturn. I want to make clear that, although the written testimony that we've submitted reflects the views of the Commission, my oral remarks and any remarks I make in response to questions set forth my own views and are not necessarily those of the Commission.

The story nationwide is no different than the one in Missouri. Rising unemployment, shrinking credit, record-setting foreclosures, and disappearing retirement accounts are causing tremendous anxiety among American consumers about their ability to make ends meet. The downturn in the economy has had a severe impact on American consumers. The unemployment rate now hovers around 10 percent, and the national foreclosure rate is now over 12 percent. To con artists, today's challenging economy presents a golden opportunity to exploit consumers' fears and bilk them out of money. The FTC is moving aggressively to stop them.

For instance, as General Koster mentioned, the troubling economic times have given rise to unscrupulous home rescue companies preying on those at risk of losing their homes through foreclosure. In the last year alone, the FTC has brought 14 cases to protect consumers from mortgage, loan modification and foreclosure rescue scams. There is more to come. We are stepping up our efforts to enforce the law against opportunists victimizing people facing foreclosure. Tomorrow, the FTC will announce another sweep,

in addition to Operation Short Change, this one focusing, in part, on mortgage rescue scams in a coordinated Federal and State law enforcement effort.

The FTC's mission goes beyond foreclosure fraud. Thousands of people have been swindled out of millions of dollars by scammers exploiting the economic downturn. The scams promise jobs, access to free government money, or the chance to earn money working from home. These promises deliver nothing. They raise people's hopes and then drive them deeper into the hole.

Two weeks ago, as the Chairman mentioned, we announced "Operation Short Change," a law enforcement sweep we undertook, along with the Department of Justice and 14 states, including, I'm proud to say, the State of Missouri, involving over 120 law enforcement actions nationwide. The FTC filed 15 cases against scams that preyed on the unemployed, scams that exploited the entrepreneurial spirit of individuals looking to start their own businesses, scams that used a false promise of free government grants, and scams that promised to deliver much needed creditor debt relief, but instead delivered more debt.

The perpetrators of these frauds used the telephone, the Internet, the television, and print ads to deceive people about what they could do for them, what doors they could open, and how much they could make, and they did it by extracting money from their consumers' accounts in a variety of ways.

I want to give you just three examples of what we have alleged in some of our complaints.

Job Safety USA promised job hunters maintenance and cleaning jobs, but it was the defendants who took the consumers to the cleaners, tricking them to pay about \$100 for a credential that would entitle them to a job. The credential was a sham and the jobs did not exist.

Grants For You Now seized on the stimulus package as the basis of its economic model. It promised access to, or expertise in, getting free government grants to pay personal expenses. It lied, plain and simple. I assure you, there is no free government stimulus money to pay down personal debts or to remodel homes.

Mutual Consolidated Savings added insult to injury by using invasive robocalls, which themselves are illegal, to offer phony lifelines to people hoping to reduce their debt burden by negotiating lower interest rates with their creditors.

Other defendants in Operation Short Change trick people into disclosing their personal financial information, resulting in months of unauthorized charges, or stole money from online consumers through unauthorized charges and debits for supposed membership service.

The Commission moved aggressively in these cases, seeking and obtaining *ex parte* temporary restraining orders with asset freezes, where possible. We are seeking a permanent halt to each of these operations, as well as the return of these ill-gotten gains to the people who were fleeced.

Now, at the FTC, we're about tough enforcement, but we would rather have no one fall victim to these scams in the first place. A critical component of our mission is to reach out to consumers and

to warn them about these scams. An educated consumer is our first line of defense.

We have produced a video, and I'd like to show you a portion of it now, which features a former telemarketer of a fraudulent business opportunity explaining exactly how he was able to lure people to part with their money. Here's a preview:

[Video presentation.]

Mr. VLADECK. I should point out that Mr. Vitale was convicted and spent over 3 years in jail for his telemarketing fraud.

We're grateful to the Committee for its continued support of our work and our mission. We're doing the best we can with the tools that are available to us. With greater resources and stronger statutory authority, we could do even a better job in protecting American consumers like Beverly Stewart.

Beverly Stewart is a single mother of two who is out of work and determined to find a job. She fell prey to an employment scam. Ms. Stewart had the courage to come forward and report the scam to the Federal Trade Commission, and our investigation into Job Safety USA, one of the scams I just mentioned, was launched because of Ms. Stewart's complaint.

Here's her story, in her own words:

[Video presentation.]

Mr. VLADECK. Informed consumers may be our best line of defense, but consumers who have been scammed, who have the courage to come speak to us and report these violations are our best friends. We would not have been able to initiate our enforcement proceeding against Job Safety USA without complaints like Ms. Stewart's.

Thank you very much for giving me this opportunity to testify before you this morning. I'd be glad to answer any questions you might have.

Thank you.

[The prepared statement of Mr. Vladeck follows:]

PREPARED STATEMENT OF DAVID VLADECK, DIRECTOR,  
BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION

Chairman Pryor, Ranking Member Wicker, and members of the Subcommittee, I am David Vladeck, Director of the Bureau of Consumer Protection at the Federal Trade Commission ("Commission" or "FTC").<sup>1</sup> I appreciate the opportunity to appear before you today to examine the types of fraud the Commission has seen during the economic downturn, describe the Commission's anti-fraud law enforcement program, and recommend changes in the law and resources the Commission needs to enhance the FTC's ability to protect consumers. During these difficult economic times, the Commission is on the job, enforcing the law, and working with a heightened urgency. This testimony will highlight *Operation Short Change*, a law enforcement sweep the Commission recently announced that has targeted entities defrauding American consumers hit by the economic downturn.

Job losses, foreclosures, and dwindling retirement accounts are forcing increasingly more Americans to search for ways to make ends meet. Opportunistic fraudsters have quickly adapted their schemes and sales pitches to take advantage of consumers during the economic downturn, with some capitalizing on the economic stimulus package. They use come-ons that offer the lure of free government grant money, guaranteed job placement, investments promising recession-proof income, ac-

<sup>1</sup> The views expressed in this statement represent the views of the Commission. My oral presentation and responses to questions are my own and do not necessarily reflect the views of the Commission or any individual Commissioner. Commissioner Kovacic dissents from portions of the testimony explained in notes 4 and note 43.

cess to credit cards, or debt relief services. These and other schemes have defrauded hundreds of thousands of consumers out of millions of dollars, and have been the focus of the Commission's ongoing law enforcement program<sup>2</sup> and consumer outreach efforts. Just 2 weeks ago, the Commission announced *Operation Short Change*,<sup>3</sup> a law enforcement sweep targeting fraudulent schemes designed to profit from the economic downturn. Together with fourteen state partners, the Department of Justice, and other agencies prosecuting criminal law violations, the Commission announced more than 120 law enforcement actions.

Today's testimony highlights the agency's current experience with and efforts to combat fraud exploiting the economic stimulus program and other fraudulent schemes preying on financially-distressed consumers. The testimony also describes the Commission's anti-fraud law enforcement program, with an overview of the tools and strategies the Commission uses to further its critical consumer protection mission. Finally, the Commission makes four important recommendations to improve the Commission's ability to protect consumers from scams and deter would-be fraudsters, including: (1) increasing resources committed to tackling fraud; (2) authorizing the agency to employ notice and comment rulemaking procedures for unfair or deceptive acts and practices under the FTC Act; (3) expanding the FTC's authority to seek civil penalties in its own right in Federal court; and (4) giving the FTC the authority to challenge practices that aid or abet violations of the FTC Act.<sup>4</sup>

### I. Financial Distress Fraud

The downturn in the economy has had a severe impact on American consumers. The unemployment rate in the United States is now 9.4 percent,<sup>5</sup> and the national foreclosure rate is over 12 percent.<sup>6</sup> With *Operation Short Change*, the Commission struck back at scams that are targeting consumers during the current economic

<sup>2</sup>The FTC has broad law enforcement responsibilities under the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. 41, *et seq.* The statute provides the agency with broad jurisdiction over most economic sectors. Certain entities or activities, however, such as banks, companies engaged in common carrier activity, and companies engaged in the business of insurance, are wholly or partly exempt from FTC jurisdiction. In addition to the FTC Act, the agency has enforcement responsibilities under more than 50 other statutes and more than 30 rules governing specific industries and practices.

<sup>3</sup>Press Release, Federal Trade Commission, FTC Cracks Down on Scammers Trying to Take Advantage of the Economic Downturn (July 1, 2009), available at <http://www.ftc.gov/opa/2009/07/shortchange.shtml>.

<sup>4</sup>Commissioner Kovacic dissents from the Commission's endorsement of authority to use, for promulgating all rules respecting unfair or deceptive acts or practices under the Federal Trade Commission Act, the notice and comment procedures of the Administrative Procedure Act. While other agencies have the authority to issue significant rules following notice and comment procedures, the Commission's rulemaking authority is unique in its range of subject matter (unfair or deceptive acts or practices) and sectors (reaching across the economy, except for specific, albeit significant, carve-outs). Except where Congress has given the Commission a more focused mandate to address particular problems, beyond the FTC Act's broad prohibition of unfair or deceptive acts or practices, Commissioner Kovacic believes it prudent to retain procedures beyond those encompassed in the APA. However, he would be willing to consider whether all the procedures currently required to issue, repeal, or amend these rules are necessary.

Commissioner Kovacic also dissents from the Commission's endorsement of across-the-board civil penalty authority. The existing consequences attendant to a finding that an act or practice is unfair or deceptive under the FTC Act include an administrative order (whose violation would then subject the respondent to civil penalties) or a court-issued injunction (which can contain such equitable remedies as redress and disgorgement). In his view, these are generally appropriate remedies, and they are consistent with the goal of developing FTC law to develop new doctrine and to reach new and emerging problems. The routine availability of civil penalties, even if subject to a scienter requirement, would in his view risk constraining the development of doctrine, much as judicial concerns about the availability of private litigation with mandatory treble damages appear to be constraining the development of antitrust doctrine. *See, e.g., Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 558–59 (2007). Commissioner Kovacic would prefer that Congress grant more targeted authority to seek civil penalties, particularly in matters where existing remedies are likely to be inadequate. *See* Prepared Statement of the Federal Trade Commission on the Commission's Work to Protect Consumers and to Promote Competition, and on a Bill to Reauthorize the Commission before the Senate Committee on Commerce, Science, and Transportation, Apr. 8, 2008, available at <http://www.ftc.gov/os/testimony/P034101reauth.pdf>.

<sup>5</sup>*See* Bureau of Labor Statistics Data (June 5, 2009), available at <http://www.bls.gov/news.release/empsit.nr0.htm>.

<sup>6</sup>*See* Mortgage Bankers Association, *Delinquencies and Foreclosures Continue to Climb in Latest MBA National Delinquency Survey* (May 28, 2009), available at <http://www.mortgagebankers.org/NewsandMedia/PressCenter/69031.htm>. According to the Mortgage Bankers Association's first quarter 2009 National Delinquency Survey, 12.07 percent of loans are either in foreclosure or delinquent by at least one payment. This is an increase over fourth quarter 2008, and is the highest rate ever recorded in the MBA national delinquency survey.

downturn. The Commission's recently filed cases fall into five broad categories of familiar fraud: (1) phony income-generating opportunities, (2) job placement scams, (3) government grant scams, (4) credit-related scams, and (5) mortgage loan modification scams. The Commission's program to combat these types of fraud centers around its enforcement of Section 5 of the Federal Trade Commission Act ("FTC Act"), which prohibits unfair or deceptive acts or practices affecting commerce. 15 U.S.C. § 45(a).

#### A. Phony Job Placement Schemes

In a time of economic distress with many Americans out of work, con-artists see the opportunity to take advantage of those seeking simply to earn an honest day's wage. Recognizing that out of work Americans can least afford to fall victim to scams, the Commission aggressively pursues employment scams.<sup>7</sup> As part of *Operation Short Change*, the Commission charged that Wagner Borges, operating as Job Safety U.S.A., targeted consumers who were searching for jobs as janitors and/or maintenance workers, using classified advertisements online and in newspapers.<sup>8</sup> The complaint alleges that the defendant told job seekers that the only thing standing between them and a new job making "\$11-\$15/hour + benefits" was a five-digit "certificate registration number" or "CRN." In truth, the CRN was a ruse used by Borges, allegedly to trick consumers to pay him \$98 for a worthless credential that did not lead to the job described. The Commission sought and obtained an *ex parte* temporary restraining order with an asset freeze to put an immediate end to Borges's scheme.<sup>9</sup>

#### B. Fraudulent Income-Generating Opportunities: Work-At-Home, Investment, and Business Opportunities

Most Americans are not looking for ways to get rich quick, but in times of economic distress, they often are looking for ways to supplement their income. Opportunists are quick to exploit the entrepreneurial spirit of Americans by hawking expensive business opportunities that purportedly will generate significant earnings. Typical business opportunity fraud involves the sale of vending machine routes or distributorships; medical billing scams; envelope stuffing scams; jewelry or craft assembly; and countless others. To convince people that the opportunity is worth the investment, hucksters sometimes give prospective purchasers the names of shells—phony references of prior customers who are purportedly experiencing significant success with the business opportunity.

The economic downturn has presented opportunities for those who would seek to capitalize on the misfortune of Americans who have seen their jobs disappear or their incomes slide. As part of *Operation Short Change*, the FTC sued two fraudulent schemes using the home foreclosure crisis as fodder for their scams. First, the Commission alleges that Family Products, LLC runs infomercials pitching money-making programs that are supposedly easy for consumers to replicate.<sup>10</sup> In one of these, the John Beck Free and Clear Real Estate System, defendants mention the high foreclosure rate our country has experienced, exploiting the crisis to pitch a program for acquiring abandoned properties for "pennies on the dollar." Like many business opportunity scams, the defendants allegedly used false testimonials to convince consumers that they could earn substantial sums of money using their programs. The Commission's June 30 complaint aims to halt the scheme and return

<sup>7</sup>The Commission has actively pursued cases against fraudsters who falsely represented that they were affiliated with or endorsed by the U.S. Postal Service, and that postal jobs were available in areas where their ads appeared. In one recent case filed against U.S. Work Alliance, the Commission charged a nationwide marketing operation with allegedly violating Federal law by deceiving consumers into buying \$120 to \$140 worth of materials they thought would help them get Federal postal jobs. *FTC v. U.S. Work Alliance, Inc.*, No. 08-CV-2053-WSD (N.D. Ga. June 19, 2008) (complaint).

<sup>8</sup>For a compelling illustration of how this type of scam harms consumers, see the statement made by Beverly Steward, a consumer who spoke during the FTC's press conference announcing *Operation Short Change*, available at [http://htc-01.media.globix.net/COMP008760MOD1/ftc\\_web/FTCindex.html#July\\_1\\_09](http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/FTCindex.html#July_1_09).

<sup>9</sup>When the Commission discovers an entity is engaged in outright fraud, it uses aggressive law enforcement tools to bring the perpetrators to justice. After assembling a case against a suspected fraud, the Commission often applies to a Federal district court for an *ex parte* temporary restraining order to halt the deceptive conduct and an asset freeze to preserve the possibility of returning money to consumer victims. Indeed, in many of the telemarketing and business opportunity cases the Commission has brought, such as those described herein, staff has sought and Federal courts have entered temporary restraining orders or preliminary injunctions.

<sup>10</sup>*FTC v. John Beck Amazing Profits, LLC*, No. 09-CV-4719 (C.D. Cal. June 30, 2009) (complaint).

money to consumers, who paid more than \$300 million for the defendants' fraudulent money-making opportunities.

Second, the FTC sued an Arizona-based scam taking advantage of consumers, including unemployed real estate agents and mortgage brokers trying to earn a living, and homeowners at risk of foreclosure.<sup>11</sup> The complaint filed against Freedom Foreclosure Prevention Services, LLC ("Freedom Foreclosure") and its principals alleges that they falsely claimed that business opportunity purchasers—after paying a fee of approximately \$1,500—could easily earn \$10,000 per month by referring homeowners for Freedom Foreclosure's loss mitigation services. In fact, the Commission charged, homeowners who turned to Freedom Foreclosure for help routinely lost their homes to foreclosure, and none of Freedom Foreclosure's 2,500 consultants earned the income they were promised for purportedly "helping" consumers out of foreclosure. On June 1, a Federal district court granted the Commission's request for an *ex parte* temporary restraining order with a freeze on the defendants' assets, and the Court later entered a stipulated preliminary injunction.

Other investment scams, such as the one the Commission alleged against an entity using the name Google Money Tree, simply lure consumers into divulging their financial account information. Google Money Tree, the FTC alleges, advertised a low-cost kit (\$3.88) that supposedly would enable consumers to earn more than \$100,000 in 6 months.<sup>12</sup> The defendants allegedly failed to disclose adequately that the small fee triggered recurring \$72.21 monthly charges for consumers. The Commission charged that by prominently displaying the Google name and logo, and disclosing only a nominal charge, the defendants convinced consumers that submitting their credit card or debit card account information would be a low risk venture. In truth, the complaint alleges, the defendants' supposed kit does not generate substantial earnings, defendants have no affiliation with Google, and they buried material terms and conditions of their offer in fine print and inconspicuously-placed hyperlinks. On June 23, a Federal court granted the FTC's *ex parte* motion for a temporary restraining order to halt the scheme and freeze the defendants' assets.

### C. Government Grant Scams

Con-artists have sought to exploit the American Recovery and Reinvestment Act of 2009 by selling purported access to or expertise in obtaining free government grants. The FTC searched the Internet to identify those websites promoting ways to obtain a piece of the economic stimulus package, and in March 2009, held a press conference to warn consumers to beware of such scams.<sup>13</sup> The event was highly successful at generating media coverage that reached consumers, as the story was picked up by national and regional media outlets. The FTC warned specifically of websites promising government grant money for any reason, even paying bills, and those that brazenly use the image of President Obama to add legitimacy to their misrepresentations. These scams ask consumers simply to provide personal information or send a very small payment to get information on how to get free government grant money. But, any financial account information in the hands of scam artists can be very costly for consumers. The Commission alerted consumers that whatever a website may say, the Federal Government does not award grants to individuals to pay personal expenses or bills, and the official source for information on available Federal Government grants is at [www.grants.gov](http://www.grants.gov), a free website operated by the U.S. Department of Health and Human Services.

As part of the Commission's efforts, it reached out to industry for help in pulling down ads for such scams. At our request, major online ad networks have agreed to screen out ads touting the economic stimulus as providing grant opportunities for individual consumers. For instance, after being contacted about this problem, Facebook voluntarily pulled off the offending ads. We want to commend these networks for their help. The Commission also issued an alert to consumers to beware of scams relating to the economic stimulus package, stating particularly that the promise of stimulus money in return for a fee or financial information is always a scam.

With *Operation Short Change*, the Commission aggressively targeted and pursued con-artists making bogus offers of free government grant money. After a painstaking investigation, on June 25, the Commission alleged that defendants operating as "Cash Grants Institute"<sup>14</sup> placed robocalls containing prerecorded messages to con-

<sup>11</sup> *FTC v. Freedom Foreclosure Prevention Services, LLC*, No. 09-CV-1167-PHX-PJM (D. Ariz. June 1, 2009) (complaint).

<sup>12</sup> *FTC v. Infusion Media, Inc.*, No. 2:09-CV-01112-RCJ (June 22, 2009) (complaint).

<sup>13</sup> Press Release, Federal Trade Commission, FTC Warns Consumers About Economic Stimulus Scams (March 4, 2009), available at <http://www.ftc.gov/opa/2009/03/stimulusscam.shtm>.

<sup>14</sup> *FTC v. Paul Navestad*, No. 09-CV-6329T (W.D.N.Y. June 25, 2009) (complaint).



sumers throughout the United States, advertising “free grant money available from Federal, state and local governments.” The complaint describes the numerous techniques the defendants allegedly used to create a false aura of legitimacy, such as placing pre-recorded calls purportedly coming from the Cash Grant Institute in Washington, D.C., using a website which includes images of President Obama and the U.S. Capitol building, and brazenly advertising a website as the “source of free money from the government.” The Commission charged that the defendants did not provide grants; instead, they just transferred consumers to other websites purportedly providing grant-related services.

Other scams wave the promise of free government grant money as a lure to obtain consumers’ financial account information and initiate recurring charges. In a case filed June 23, again, after an intensive investigation, the Commission alleged that website operators, using names like Grants for You Now,<sup>15</sup> represented that consumers who purchased their product would be likely to receive a government grant. One website, ornamented with the image of a suitcase bursting with money and boldly identifying specific Federal Government grants for housing and education, proclaimed that “anyone who needs money for” paying off debt, home repair, and personal expenses can “benefit.” Instead, the complaint charges, consumers who purchased the defendants’ software program unwittingly enrolled in a negative option continuity program, subjecting them to recurring monthly charges of nearly \$100. In both cases, the Commission acted aggressively to put an immediate end to the fraud, seeking and obtaining *ex parte* temporary restraining orders and asset freezes from Federal district courts.

#### D. Credit-Related Frauds

With the tightening of credit in the marketplace, telemarketers and online sellers of advance-fee credit cards are aggressively targeting consumers. Consumers with poor credit histories are enticed with offers guaranteeing loans or general-purpose credit cards regardless of their credit histories. Often, the sales pitch includes false claims that the seller reports to the major credit bureaus and that the credit program will help the consumer build his credit. Consumers who pay a fee in advance to receive the purported credit card often discover that all they have received in return is either a stored value or debit card or a catalog card that can be used only to purchase merchandise from a particular paper or online catalog.

This past February, as part of *Operation Short Change*, the Commission sued Group One Networks, a network of companies allegedly engaged in a telemarketing scheme to trick consumers into paying hundreds of dollars for credit cards that could only be used to purchase goods from a limited number of online catalog websites.<sup>16</sup> The Commission charged that as part of the scheme, defendants allegedly obtained the financial account information of consumers who filled out online payday loan applications and, without the consumers’ knowledge or consent, charged them for a worthless credit card membership. Moving aggressively to halt these alleged law violations, the Commission sought and obtained an *ex parte* temporary restraining order, and later a preliminary injunction.

Another scheme affecting consumers with credit problems is debt relief services. On June 25, the Commission sued Mutual Consolidated Savings,<sup>17</sup> a company that allegedly placed pre-recorded or “robocalls” to market a supposed “rapid debt reduction” program. The defendants allegedly told consumers they would generate thousands of dollars in savings by negotiating interest rate reductions with their credit card companies, and they promised a refund of the \$690 to \$899 fee if they failed. The FTC alleged that defendants did fail, often refusing to refund consumers and leaving them even deeper in debt. The Commission sought and obtained an *ex parte* temporary restraining order and an asset freeze on June 26.

Debt settlement companies also offer debt relief to consumers, promising for a fee to obtain a lump sum settlement from the creditor of the consumer’s credit card debt. These companies typically promise that they will negotiate with creditors to obtain settlements for amounts less than the full balance that the consumer owes. The FTC has brought a number of lawsuits against for-profit debt settlement companies that do not deliver on their promises.<sup>18</sup> In some of these cases, the companies allegedly deceived consumers who were seeking help with their credit card bills into paying large up-front fees for debt relief services that were never provided. Some

<sup>15</sup> *FTC v. In Deep Services, Inc.*, No. EDCV-09-1193-SGL (PGWx) (June 22, 2009) (complaint).

<sup>16</sup> *FTC v. Group One Networks, Inc.*, No. 8:09-CV-0352-T-26-MAP (M.D. Fla. Feb. 25, 2009) (complaint).

<sup>17</sup> *FTC v. MCS Programs, LLC*, No. C09-5380RBL (W.D. Wash. June 25, 2009) (complaint).

<sup>18</sup> See *FTC v. Edge Solutions, Inc. of New York*, No. CV-07-4087-JG-AKT (E.D.N.Y. Aug. 7, 2008) (stipulated order and judgment for permanent injunction).

of the companies also falsely promised consumers that not paying their creditors would not hurt their credit ratings, and that purchasing their services would stop debt collectors from calling them. In addition to taking these law enforcement actions, the FTC last year convened a workshop to learn more about the debt settlement industry and develop solutions to the consumer protection problems they cause.<sup>19</sup>

#### *E. Loan Modification and Foreclosure Rescue Services*

With the rapid increase in mortgage delinquencies and foreclosures, the FTC has stepped up its efforts to protect consumers from mortgage loan modification and foreclosure rescue scams. In a little over a year, the FTC has brought 14 cases targeting these scams,<sup>20</sup> and is currently engaged in additional non-public investigations of providers of loan modification and foreclosure rescue services.

The FTC's law enforcement actions in this area typically have alleged the following: First, the defendants used terms like "guarantee" and "97 percent success rate" to mislead consumers about the effectiveness of the services they provide. Second, they charged up-front fees for their services. Last, after collecting the fee, the defendants did little or nothing to help consumers obtain a loan modification or stop foreclosure. Such operations not only defraud financially-distressed consumers out of desperately needed funds but also may lead them to forgo viable options to help them with their mortgage payments, such as getting assistance from a non-profit housing counselor, or discussing their payment problems with their servicer and continuing their payments.

Sometimes, the defendants allegedly have used copycat names or look-alike websites to misrepresent that they are affiliated with a non-profit or government entity.<sup>21</sup> The Commission, for example, recently filed two actions alleging that defendants used similar sounding names and other claims to misrepresent that they were part of the legitimate Hope Now Alliance of housing counselors and mortgage servicers.<sup>22</sup> Similarly, the Commission recently filed an action alleging that defendants misrepresented that they were affiliated with the Administration's "Making Home Affordable" programs.<sup>23</sup> Defendants also sometimes allegedly misrepresent that Members of Congress or other government officials endorse their services or products.<sup>24</sup>

In addition to bringing law enforcement actions, the FTC has commenced a rulemaking to address unfair and deceptive acts and practices related to loan modification and foreclosure rescue services. Any proposed rules that the FTC would issue as part of this rulemaking would apply only to entities within the FTC's jurisdiction under the FTC Act, which excludes banks, thrifts, and Federal credit unions, among others. The Commission issued its advanced notice of proposed rulemaking on June 1, 2009, and the public has 45 days in which to file comments in response to this notice.<sup>25</sup> Because of the serious risks to consumers in the current financial crisis,

<sup>19</sup> See Federal Trade Commission, Debt Settlement Workshop (Sept. 25, 2008), Transcript, available at <http://www.ftc.gov/bcp/workshops/debtsettlement/OfficialTranscript.pdf>.

<sup>20</sup> *FTC v. Data Medical Capital, Inc.*, No. SA-CV99-1266AHS (C.D. Cal. filed May 27, 2009); *FTC v. Dinamica Financiera LLC*, No. CV09-3554MMM (C.D. Cal. filed May 19, 2009); *FTC v. One or More Unknown Parties Misrepresenting Their Affiliation With the Making Home Affordable Program*, No. CV-09-894 (D.D.C. filed May 14, 2009); *FTC v. Federal Loan Modification Law Center, LLP*, No. SACV09-401 CJC (C.D. Cal. filed Apr. 3, 2009); *FTC v. Thomas Ryan*, Civil No. 1:09-00535 (D.D.C. filed Mar. 25, 2009); *FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009); *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. National Foreclosure Relief, Inc.*, No. SACV09-117 (C.D. Cal. Feb. 2, 2009); *FTC v. United Home Savers, LLP*, No. 8:08-cv01735-VMC-TBM (M.D. Fla. Sept. 3, 2008); *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv01075 (N.D. Ohio April 28, 2008); *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv388-T-23EAJ (M.D. Fla. Feb. 26, 2008); *FTC v. National Hometeam Solutions, Inc.*, No. 4:08-cv-067 (E.D. Tex. Feb. 26, 2008); *FTC v. Safe Harbour Foundation*, No. 08 C 1185 (N.D. Ill. Feb. 25, 2008).

<sup>21</sup> See *FTC v. Thomas Ryan*, Civil No. 1:09-00535 (HHK) (D.D.C. filed Mar. 25, 2009).

<sup>22</sup> *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. filed Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. filed Mar. 17, 2009). In these two cases, the court issued temporary restraining orders and asset freezes against the defendants. Both defendants later agreed to stipulated preliminary injunctions.

<sup>23</sup> *FTC v. One or More Unknown Parties Misrepresenting Their Affiliation with the Making Home Affordable Program*, No. CV-09-894 (D.D.C. May 14, 2009) (complaint).

<sup>24</sup> See *FTC v. Federal Loan Modification Law Center, LLP*, Case No. SACV09-401 CJC (C.D. Cal. filed Apr. 3, 2009). See also Press Release, *Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams* (Apr. 6, 2009), available at <http://www.ftc.gov/opa/2009/04/hud.shtm>.

<sup>25</sup> 74 Fed. Reg. 26,118 (June 1, 2009).

the FTC will proceed as expeditiously as practicable in conducting this rulemaking proceeding as a complement to its vigorous law enforcement efforts.

## II. Sustained FTC Enforcement and Other Activities Targeting Fraud

In addition to the law enforcement activities described above, the Commission also targets fraud by enforcing the Telemarketing Sales Rule and the Business Opportunity Rule.<sup>26</sup> With these rules, the Commission's anti-fraud law enforcement program reaches fraud perpetrated through telemarketing, print advertising, and, with ever increasing frequency, online.

### A. Enforcement of the Telemarketing Sales Rule

The Commission has developed a robust law enforcement program against fraudulent telemarketers. Since the 1996 promulgation of the Telemarketing Sales Rule ("TSR"),<sup>27</sup> which now includes the privacy protections of the National Do Not Call ("DNC") Registry,<sup>28</sup> the Commission has initiated 271 telemarketing cases aimed at halting various telemarketing frauds, such as unauthorized debiting of consumers' financial accounts, as well as the deceptive sales of various goods and services, including work-at-home opportunities, advance-fee credit cards, government grants, sweepstakes and prize promotions.<sup>29</sup> The Commission's efforts have broadly targeted not only fraudulent telemarketers, but also the third-parties that assist them. Many of the Commission's actions have been brought as part of coordinated law enforcement sweeps of the telemarketing industry, such as *Operation Tele-PHONEY*, which included 180 actions by state, Federal, and international law enforcement agencies to crack down on telemarketing fraud.<sup>30</sup> Many cases against deceptive telemarketers also allege violations of the Do Not Call or related privacy protection provisions of the TSR. Twenty-eight cases have alleged only violations of Do Not Call and/or other privacy provisions of the TSR. Ultimately, almost all of these cases resulted in permanent injunctions against the defendants which severely restricted or banned defendants' deceptive or abusive marketing sales practices. The pursuit of these cases by the Commission has resulted in orders providing for over \$540 million in consumer restitution or, where that was not practicable, disgorgement to the U.S. Treasury. During this period, through cases filed on its behalf by the U.S. De-

<sup>26</sup>Telemarketing Sales Rule, 16 C.F.R. Part 310; Business Opportunity Rule, 16 C.F.R. Part 437.

<sup>27</sup>In 1994, Congress enhanced the Commission's legal arsenal against fraud by enacting the Telemarketing and Consumer Fraud and Abuse Prevention Act (the "Telemarketing Act"), 15 U.S.C. §§ 6101–6108, which directed the Commission to issue a trade regulation rule defining and prohibiting deceptive or abusive telemarketing acts or practices. Accordingly, the Commission promulgated the TSR in 1995, which is codified in the Code of Federal Regulations, 16 C.F.R. Part 310.

<sup>28</sup>In December 2002, the Commission adopted amendments to the TSR that, among other things, established the National Do Not Call Registry, prohibited call abandonment, required (where feasible) transmission of Caller ID identifying information, and established important new safeguards in situations where telemarketers use preacquired account information. 68 Fed. Reg. 4580 (Jan. 29, 2003). The TSR also was recently amended to, among other things, bar telemarketing calls that deliver pre-recorded messages (so-called "voice blasting" or "robo calls"), unless the consumer previously has agreed to accept such calls from the seller. Those amendments will become fully effective in September 2009. TSR Final Rule Amendments, 73 Fed. Reg. 51164 (Aug. 29, 2008).

<sup>29</sup>Prior to the enactment of the TSR, the Commission brought 110 telemarketing cases pursuant to Section 5 of the FTC Act, which prohibits "unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. § 45(a).

<sup>30</sup>"Operation Tele-PHONEY" <http://www.ftc.gov/opa/2008/05/telephoney.shtm>. The following is a sampling of some of the sweeps that the FTC and its law-enforcement partners have conducted over the past several years: "Dialing for Deception," <http://www.ftc.gov/opa/2002/04/dialing.shtm> (a sweep by the FTC that targeted telemarketing fraud in connections with inbound telephone calls); "Ditch the Pitch," <http://www.ftc.gov/opa/2001/10/ditch.shtm> (a sweep targeting fraudulent out-bound telemarketing brought by the FTC and 6 states); "Operation No Credit," <http://www.ftc.gov/opa/2002/09/opnocredit.shtm> (43 law enforcement actions, including criminal indictments, targeting a wide range of credit-related fraud brought by the FTC, the DOJ, the U.S. Postal Inspection Service, and 11 state and local authorities); "Operation Protection Deception," <http://www.ftc.gov/opa/2000/10/protectdecept.shtm> (a sweep against telemarketers of fraudulent "credit card protection" services with extensive assistance from 5 states and the Federal Bureau of Investigation ("FBI")); "Senior Sentinel," <http://www.ftc.gov/opa/1995/12/sen.shtm> (a sweep targeting telemarketers who defraud the elderly coordinated by the DOJ and FBI, with 5 civil cases brought by the FTC, that led to hundreds of arrests and indictments across the country); "Project Telesweep," <http://www.ftc.gov/opa/1995/07/scam.shtm> (nearly 100 cases filed by the FTC, DOJ and 20 states targeting business opportunity fraud often promoted through slick telemarketing).

partment of Justice,<sup>31</sup> the Commission has obtained civil penalty orders and equitable monetary relief totaling nearly \$31 million.

#### *B. Enforcement of the Business Opportunity Rule*

Like its telemarketing anti-fraud program, since 1981, the Commission has had a vigorous program to pursue fraudulent purveyors of business opportunities, scams which can cost individual consumers thousands of dollars. The Commission uses Section 5 of the FTC Act to pursue business opportunity fraud, often charging violations of the Business Opportunity Rule (formerly, the Franchise Rule), as well.<sup>32</sup> Since 1981, the Commission has initiated over 262 actions to halt business opportunity schemes promising money through vending machine routes, medical billing, rack display, Internet kiosk, 900-number ventures, envelope stuffing, and many other schemes.

The Commission routinely works cooperatively with other Federal and state law enforcement agencies to combat business opportunity fraud, often leading sweeps of the industry. Since 1995, the Commission has conducted more than 15 business opportunity sweeps to combat persistent business opportunity fraud.<sup>33</sup> These sweeps bring public attention to these types of fraud and heighten consumer awareness of how to avoid losing money in these schemes. Through the Business Opportunity Rule itself, which requires that sellers make certain pre-sale disclosures to prospective purchasers, the Commission aims to put material information into consumers' hands before they make a hefty investment in a business opportunity.<sup>34</sup>

The Commission values the cooperative relationships it has fostered with the states and other Federal agencies. Although the Commission does not have criminal law enforcement authority, it recognizes the importance of criminal prosecution to deterrence and consumer confidence. Accordingly, the Commission routinely refers matters appropriate for criminal prosecution to Federal and state prosecutors through its Criminal Liaison Unit ("CLU"). Since October 1, 2002, 349 people have been indicted and 238 have been convicted in criminal cases that arose from referrals made by CLU, including cases where an FTC attorney was designated a Special Assistant U.S. Attorney to help with the criminal prosecution.

#### *C. Consumer and Business Education*

In addition to the Commission's law enforcement activities, the agency reaches out to consumers to give them the tools they need to recognize and avoid fraud. In response to the recent economic downturn, the FTC developed several initiatives to help people manage their financial resources, avoid fraud, and be aware of emerging

<sup>31</sup>Civil penalty actions are filed by the Department of Justice ("DOJ") on behalf of the FTC. In general, under the FTC Act, the Commission must notify the Attorney General of its intention to commence, defend, or intervene in any civil penalty action under the Act. 15 U.S.C. § 56(a)(1). DOJ then has 45 days, from the date of the receipt of notification by the Attorney General, in which to commence, defend or intervene in the suit. *Id.* If DOJ does not act within the 45-day period, the FTC may file the case in its own name, using its own attorneys. *Id.*

<sup>32</sup>Until 2007, business opportunities were covered under the original Franchise Rule, 16 C.F.R. Part 436. In 2007, the Commission amended Part 436 to apply only to business format franchises, and created Part 437 to cover business opportunities. *Final Rule on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities*, 72 Fed. Reg. 15444 (March 30, 2007). The Business Opportunity Rule is identical to the corresponding portions of the original Franchise Rule except that it deletes the definitional elements and references regarding business format franchising that are now covered by the amended Franchise Rule. *Id.*

The Business Opportunity Rule, Part 437, is currently under regulatory review and is in the process of being amended. *See Notice of Public Workshop on the Business Opportunity Rule*, 74 Fed. Reg. 18712 (April 24, 2009). Among other things, the proposed amendments would expand the scope of the rule to cover entities that previously were not covered under the Franchise Rule, such as many work-at-home schemes. The amendments also would simplify the disclosure document that sellers are required to provide prospective purchasers.

<sup>33</sup>*E.g.*, Project False Hope\$ (2006); Project Biz Opp Flop (2005); Project Busted Opportunity (2002); Project Bizillion\$ (1999); Operation Money Pit (1998); Project Vend Up Broke (1998); Project Trade Name Games (1997); Operation Missed Fortune (1996); and Project Telesweep (1995). In addition to joint law enforcement sweeps, Commission staff has also targeted specific business opportunity ventures such as envelope stuffing (Operation Pushing the Envelope 2003); medical billing (Operation Dialing for Deception 2002, and Project Housecall 1997); seminars (Operation Showtime 1998); Internet-related services (Net Opportunities 1998); vending (Project Yankee Trader 1997); and 900 numbers (Project Buylines 1996).

<sup>34</sup>The Business Opportunity Rule requires sellers to make numerous disclosures to consumers, such as, among other things, the seller's litigation history, a list of prior purchasers of the business opportunity, the seller's refund and cancellation policy, and if the seller makes a claim about likely earnings, the basis for that claim. 16 C.F.R. Part 437.1(a)(4), (7), (16)(iii); 437.1(b)(3).

scams. We share our consumer education materials with state attorney general offices and various local organizations to help get the word out to the public.

For instance, with *Operation Short Change*, the Commission developed and released a video to educate the public on business opportunity fraud.<sup>35</sup> The video features a former con-artist, Jim Vitale, describing the tools of the trade, including the techniques he used to rush consumers into sending their money. It provides a sobering glimpse into the lives of two individuals who lost money in business opportunity scams, and it gives consumers concrete advice on what they should do before investing in a business opportunity.

In conjunction with a Federal-state crackdown on mortgage foreclosure rescue scam operators, the FTC produced a toolbox of mortgage-related resources for homeowners in distress; they are featured on a new web page at [www.ftc.gov/MoneyMatters](http://www.ftc.gov/MoneyMatters). Indeed, groups including NeighborWorks America, and the Homeowners Preservation Foundation—a nonprofit member of the HOPE NOW Alliance of mortgage industry members and U.S. Department of Housing and Urban Development-certified counseling agencies—are distributing FTC materials directly to homeowners at borrower events across the country, on their websites, in their statements, and even on the phone: when people call the Nation's major mortgage servicers, they hear about the tell-tale signs of a mortgage foreclosure scam while they are on hold. Next month, the agency will distribute to thousands of community organizations, HUD-certified housing counselors, and state attorneys general across the Nation copies of a new video featuring the stories of real people who are working with legitimate counselors to save their homes from foreclosure.

The agency has focused outreach efforts on a number of other issues faced by people in economic distress, including stimulus scams, rental scams, church “opportunity” scams, offers for bogus auto warranties, and solicitations for phony charities that play on the public's concern for the welfare of our military troops and public safety personnel, especially at a time when budgets are shrinking.

Finally, in an effort to stem the number of false or misleading claims that consumers see, the agency has a publication for publishers and broadcasters to alert them to the kinds of claims—extravagant earnings promises, for example—that can signal a rip-off. The Commission also offers sample public service announcements that newspapers can run in the business opportunity section of their classified section to remind readers to do their homework before buying a business opportunity.

#### *D. Research and Policy Development*

To complement its law enforcement and educational initiatives, the Commission regularly conducts research to stay abreast of marketplace developments, and ensure the agency is best situated to prevent, deter, and halt consumer fraud. Toward these ends, the Commission has conducted two consumer fraud surveys, in 2003 and 2005, seeking to quantify fraud in the United States, and will continue to conduct research in 2010.<sup>36</sup>

More recently, to examine consumer fraud in depth, the Federal Trade Commission staff held a two-day Fraud Forum on February 25 and 26, 2009. In addition to Federal, state and international law enforcers, staff invited consumer advocates, business representatives, criminologists and sociologists, all of whom share a keen interest in understanding fraud, and identifying ways to more effectively protect consumers from fraudulent schemes.<sup>37</sup> The purposes of the Forum were both to gain a greater understanding of fraud and the ways that fraud artists ply their trades, and to harness the collective knowledge and experience of Forum participants to advance anti-fraud initiatives.

The Forum focused on the dynamics of fraud, including common traits of fraudsters and characteristics of victims in order to develop better methods of deterrence and prevention. As a reminder to law enforcement of the threat posed by the economic downturn, Jim Vitale, a former con-artist who participated in the forum, aptly noted: “I’d have to say that the potential for business opportunity fraud is

<sup>35</sup> Available at <http://www.ftc.gov/multimedia/video/scam-watch/fraud-inside-look.shtm>.

<sup>36</sup> Reports of the results of those two surveys, “Consumer Fraud in the United States: An FTC Survey, FTC Staff Report,” (Aug 2004) (“2003 Survey”) and “Consumer Fraud in the United States: The Second FTC Survey, FTC Staff Report,” (Oct 2007) (“2005 Survey”) are available at <http://www2.ftc.gov/reports/consumerfraud/040805confraudrpt.pdf> and <http://www2.ftc.gov/opa/2007/10/fraud.pdf>, respectively.

<sup>37</sup> Panelists and presenters at the Fraud Forum included 20 representatives from 16 Federal, state, and international law enforcement or consumer protection agencies.

greater now than it would be in a booming economy . . . If the right marketing is done, it's [the] perfect storm."<sup>38</sup>

Looking ahead, the Commission will be hosting a roundtable this fall to examine consumer protection issues that arise in debt collection proceedings against individual consumers.<sup>39</sup>

### III. Enhancing the FTC's Fraud-Fighting Tools

The cases discussed in this testimony are only part of the Commission's continuous efforts to protect financially-distressed consumers from fraud during the current economic downturn. An effective program depends on communication with the public to help the Commission spot fraud, track complaints, and provide Americans with tools that will help them avoid falling prey to fraud. Fraud investigations are aided by the Commission's considerable investment in technology, such as Consumer Sentinel, a database of complaints collected from consumers. As noted above, the Commission's law enforcement sweeps provide an opportunity to reach the public through media coverage of law enforcement crack-downs on fraud. And, through the use of consumer alerts, such as the Commission's warning to consumers about economic stimulus grant scams (March 2009),<sup>40</sup> and consumer education, such as the FTC's website "Money Matters" (March 2009),<sup>41</sup> the Commission strives to give consumers the most current resources to help them spot and avoid financial scams.

The agency's vigorous pursuit of its consumer protection mission, however, is hampered by the Commission's insufficient resources and its limited authority. Increased resources and certain expansions of its legal authority would improve the Commission's ability to act quickly to protect consumers from scams and would serve to deter would-be fraudsters and those who assist them.<sup>42</sup> To that end, the Commission first asks Congress to provide the agency with more resources to increase its law enforcement and consumer protection activities. Second, the Commission recommends that Congress authorize the agency to employ notice and comment rulemaking procedures for unfair and deceptive acts and practices under the FTC Act. Third, the Commission recommends that Congress authorize the FTC to seek civil penalties for violations of Section 5 of the FTC Act and, to promote efficiency and expediency, to seek civil penalties in its own right in Federal court without being required to refer enforcement of civil penalty proceedings to the U.S. Department of Justice.<sup>43</sup>

Finally, the Commission believes that an expansion of its authority to include the ability to challenge practices that aid or abet violations of the FTC Act, could be beneficial to the Commission's consumer protection law enforcement program.<sup>44</sup> Effective law enforcement often requires reaching not only the direct participants in unfair or deceptive practices, but also those who support and enable the direct participants to violate the law.<sup>45</sup> The need for this authority has become particularly

<sup>38</sup> Federal Trade Commission, Fraud Forum, *Panel 1: Becoming a Scam Artist, Understanding the Victim: Exploring the Psychology of Scammers and Victims*, at 45–46 (February 25–26, 2009), transcript available at [http://htc-01.media.globix.net/COMP008760MOD1/ftc\\_web/transcripts/022509\\_sess1.pdf](http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/transcripts/022509_sess1.pdf). Vitale's input at the fraud forum was leveraged in making the educational video released as part of *Operation Short Change*. See *supra* note 33.

<sup>39</sup> Available at <http://www.ftc.gov/opa/2009/06/chicagoround.shtm> (press release).

<sup>40</sup> Available at <http://www.ftc.gov/opa/2009/03/stimulusscam.shtm> (press release) and [http://htc-01.media.globix.net/COMP008760MOD1/ftc\\_web/FTCindex.html#March\\_4\\_09](http://htc-01.media.globix.net/COMP008760MOD1/ftc_web/FTCindex.html#March_4_09) (webcast of press conference).

<sup>41</sup> Available at <http://www.ftc.gov/moneymatters>.

<sup>42</sup> These recommendations are discussed in greater detail in the FTC's April 8, 2008 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at <http://www2.ftc.gov/os/testimony/P034101reauth.pdf>.

<sup>43</sup> Please see Commissioner Kovacic's dissent in note 4.

<sup>44</sup> Since the Supreme Court's ruling in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), which cast doubt on the argument that Section 5 of the FTC Act could reach "aiding and abetting" another person's violation, the Commission's ability to pursue those who assist and facilitate unfair or deceptive acts and practices has been compromised. Although the Commission has developed alternative "assistance" theories to reach secondary actors, these theories may make liability more difficult to prove than if the FTC had specific statutory authority in this area. See, e.g., *FTC v. Winstead Hosiery Co.*, 258 U.S. 483, 494 (1922) (establishing the doctrine that providing the means and instrumentalities by which unfair or deceptive practices occur is itself an unfair or deceptive practice in violation of the FTC Act).

<sup>45</sup> The Telemarketing Act is one statute that specifically gives the FTC express authority to pursue aiders and abettors. 15 U.S.C. § 6102(a)(2). Based on this express authority, Section 310.3(b) of the TSR prohibits providing "substantial assistance or support to any seller or telemarketer when that person knows or consciously avoids knowing that the seller or telemarketer" is engaged in certain practices that violate the Rule. 16 C.F.R. § 310(b). The Commission has included an "assisting and facilitating" allegation in at least two dozen cases since the

clear in the Internet era, in which online frauds involve numerous actors with murky and varying roles in complicated channels of distribution. Making it easier for the Commission to challenge those who provide assistance to others who are violating Section 5 of the FTC Act could help the agency attack the infrastructure that supports Internet fraud, such as in the online scams described above.

#### IV. Conclusion

The economic downturn has shown how quickly and easily opportunists adopt schemes to take advantage of individuals in financial distress. The Commission is committed to using its law enforcement authority aggressively to bring these schemes to a halt, and to continue deploying public alerts and educational materials to help consumers avoid being victimized in the first instance. The Commission supports legislation that would help it do more to protect consumers by authorizing it to issue consumer protection rules and obtain civil penalties for violations of those rules.

Thank you for providing the Commission with the opportunity to appear before the Committee to describe its efforts in this critical area.

Senator PRYOR. Thank you.

Our next witness will be Chuck Bell, Director of Programs, Consumers Union.

#### STATEMENT OF CHARLES BELL, DIRECTOR OF PROGRAMS, CONSUMERS UNION

Mr. BELL. Good morning, Mr. Chairman and Members of the Committee. Thank you very much for holding this hearing on ways to protect consumers, during the current economic downturn, against deceptive practices, fraud, and scams.

Consumers Union is the independent, nonprofit publisher of *Consumer Reports*, with a circulation of 7 million, *Consumer Reports* plus *ConsumerReports.org* subscribers. As part of our work, we regularly research and report on misleading and deceptive practices that affect consumers. We report on scams and fraud, both to alert consumers so they can protect themselves, and also to alert law enforcement agencies and policymakers so they can take action to directly curtail and stop these unethical, deceptive, and fraudulent practices.

Over the last several months, we have reported on a variety of anticonsumer practices that are affecting financially-distressed families which we think are worthy of attention by your committee.

As the Committee is well aware, this is a very tough time for workers and consumers, and, when the economy falters, it's prime time for plays that claim to help consumers get out of money messes. Consumers are at risk for a variety of get-rich-quick schemes and financial cons that target them specifically because they need fast help and are increasingly desperate.

While many such frauds exist in both good and bad times, the con artists appear to expand their marketing efforts in recessions and come up with very clever angles to attract new victims.

In March, *Consumer Reports* published "Financial Traps are Flourishing," an article that profiles several very costly financial traps that prey on financially-distressed consumers. Some of the financial traps include foreclosure rescue scams, hard-sell reverse mortgages, and high debt settlement services.

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TSR was adopted. See, e.g., *FTC v. Assail, Inc.*, No. W03CA007 (W.D. Tex. final orders entered Jan. 2005); *U.S. v. DirecTV, Inc.*, No. SACV05 1211 (C.D. Cal. final order entered Dec. 2005); *U.S. v. Entrepreneurial Strategies, Ltd.*, No. 2:06-CV-15 (WCO) (N.D. Ga. final order entered Jan. 2006).

Briefly, the foreclosure rescue scams, we profiled an Illinois family who lost their home when a company promising loan modification and rescue services left them high and dry after receiving an up-front fee of \$1,347. More than 200 Illinois consumers experienced the same problems or similar problems with this firm, according to a complaint by the Illinois Attorney General. We believe that the collection of advance fees for loan modification schemes and debt settlement is a key problem, and we are currently supporting State legislation in California aimed at prohibiting the collection of advance fees for foreclosure rescue.

This is a national problem, with a projected 3.5 million mortgage foreclosures set to take place this year, so Consumers Union is very pleased that the FTC is now using its powers to promulgate rules prohibiting or restricting unfair or deceptive acts or practices concerning mortgage servicing and loan modification and rescue schemes.

With respect to hard-sell reverse mortgages, our March article also warned consumers against the dangers of hard-sell reverse mortgages. Banks and mortgage lenders are targeting seniors, with a blitz of television ads to entice them to take equity out of their homes through reverse mortgages. In an economy when many families' savings have plummeted, such offers may, indeed, be attractive, but the lenders often bundle high fees, insurance charges, and commissions into the loan and try to aggressively cross-sell consumers with other types of financial products, such as annuities, which may well not be suitable for them.

Consumers Union believes that the sellers of reverse mortgages should be required to make sure that the loan is suitable for the borrower and that there is independent, one-on-one premortgage counseling. We also believe there should be caps on origination fees for all reverse mortgages, and better restrictions on sales practices.

We commend Senator Claire McCaskill, whose proposed legislation in this area aimed at preventing fraud and reverse mortgages and requiring that ads for government-backed mortgages present a balanced view of their risks and benefits.

High fee debt settlement. We profiled a family ensnared by a company offering these services, who collected the fees, but provided no significant services. This industry, as we heard earlier, has expanded rapidly as consumer debt has grown and changes in Federal laws made it very difficult to file for personal bankruptcy. Attorney generals in New York and Texas have filed suit against debt settlement companies for failing to provide services to customers. We believe that the FTC should ban the charging of advance fees in debt settlements and cap fees based solely on a low percentage of the amount of which the debt is actually and permanently reduced below the amount owned—owed when the debt settlement contract was first signed.

In addition, we believe all of these financial problems could be dramatically reduced if Congress will pass legislation to create a consumer financial protection agency which would meet a critical public need for stronger consumer protection and financial services, both by more carefully reviewing the financial products that are offered and strengthening enforcement in response to consumer problems and complaints.



In recent months, *Consumer Reports* and other consumer protection officials have also warned about a range of other recession-related Internet scams related to employment and work, and these include job search services, unemployment benefit scams, work-at-home schemes, and websites that promise access to government grants.

We very much appreciate the efforts of the FTC and other consumer watchdog groups and regulators to shut down such practices. We would also encourage media and Internet companies that accept advertising to carefully scrutinize the advertisements that make unsupported promises and take advantage of financially-stressed consumers or ads that make unethical or questionable claims. We believe that, as a matter of corporate responsibility, companies that accept advertising should not be setting consumers up for financial heartbreak.

The diverse financial come-ons and ripoffs described here today come in a variety of forms and permutations, and, unfortunately, don't lend themselves to a one-size-fits-all silver-bullet solution. However, we believe that everyone, across the board, needs to do more, starting with the consumer, who has to be ever on their guard, very skeptical of offers of financial help and extra income, and particularly when those offers come from businesses they don't know or have an unfamiliar track record. We also think businesses should exercise more corporate responsibility, and they should redesign or withdraw products with high fees or financial traps built into them.

We think it's also a critical time to provide generous resources to our State and Federal regulators so that they can step up the enforcement of companies that deceive and defraud consumers. Our public agencies are on the front line of fighting these practices, and they should impose sharp civil and criminal penalties for companies that violate the law.

We would also urge State and Federal policymakers to consider new consumer protections against unfair and deceptive practices. Economic fraud has a high financial and personal cost for consumers, and it could undermine public confidence in the marketplace in a renewed economy.

We hope our Nation will lift up our financially-distressed families, and not push them down with deceptive practices and drive them further into debt.

Thank you very much, and I look forward to answering any questions.

[The prepared statement of Mr. Bell follows:]

PREPARED STATEMENT OF CHARLES BELL, PROGRAMS DIRECTOR, CONSUMERS UNION

### **Introduction**

Mr. Chairman, Members of the Committee:

Thank you very much for the invitation to testify on ways to protect consumers against deceptive practices, fraud and scams during the current economic downturn. We commend you for holding this hearing to focus attention on ways to protect consumers and encourage a safer marketplace.

Consumers Union<sup>1</sup> is the independent, non-profit publisher of *Consumer Reports*, with circulation of over 7 million (*Consumer Reports* plus *ConsumerReports.org* subscribers). As part of our work, we regularly research and report on misleading and deceptive practices that affect consumers. We report on scams and fraud both to alert consumers, so they can protect themselves; and to alert law enforcement agencies and policymakers, so they can take action to directly curtail and stop these unethical, deceptive and/or fraudulent practices.

Over the last several months, we have reported on a variety of anti-consumer practices that are affecting financially-distressed families which we think are worthy of attention by your Committee.

These diverse financial come-on and ripoffs come in a variety of forms and permutations, and unfortunately do not lend themselves to a one-size-fits all, silver bullet solution. However, we believe that given the risks to consumers, everyone must do more:

- Consumers must be ever on their guard, and be very, very skeptical of offers of financial help and extra income, particularly when those offers come from businesses they don't know, or have an unfamiliar track record. They should seek second opinions and advice from knowledgeable and respected sources of information, including trusted friends, consumer protection agencies and watchdog groups, government agencies, attorneys, homeownership counselors and others, prior to handing over cash, or signing contracts or agreements that obligate them financially.
- Businesses that sell products with high fees or financial traps built into them should withdraw or redesign such products, or in other cases provide much better disclosure, counseling and protections for customers. In addition, businesses have an important role to play in strengthening the protection of sensitive customer information, to prevent security breaches and identity theft.
- Media and Internet companies that accept advertising should carefully scrutinize advertisements for products or services that make unsupported promises, take advantage of financially-stressed consumers, or make unfair, unethical or questionable claims. As a matter of corporate responsibility, companies that accept advertising should not be setting consumers up for financial heartbreak. To their credit, some Internet search companies now specifically warn consumers about websites that could include spyware or malware. These companies may be able to do much more to reduce and suppress deceptive ads, and warn consumers against financial scam websites that receive failing grades from watchdog groups and/or government regulators.
- State and Federal regulators should step up enforcement of companies that deceive and defraud consumers, and impose sharp criminal and civil penalties for companies that violate the law.
- State and Federal policymakers should consider new consumer protections to protect consumers against unfair and deceptive practices that target financially-distressed households. In particular, legislation pending before Congress to establish a Consumer Financial Protection Agency would greatly help to protect consumers in good times and bad, and ensure that laws against deceptive practices and fraud are effectively enforced.
- Economic fraud has a high financial and personal cost for consumers, could undermine public confidence in the marketplace and a renewed economy. Consumer protection should be a pillar of economic reconstruction, to ensure that people who work hard and save for the future will not be unfairly deprived of their income and assets.

### **Rising Unemployment Fuels Consumer Financial Distress**

As the Committee is well aware, this is a very tough time for workers and consumers. The official unemployment rate is 9.5 percent, the highest in 25 years. 14.7 million people are unemployed, and another 9 million people are working part-time because they can't find a full-time job. This is now the worst recession in post-World War II history in terms of total jobs losses. Mass layoffs—job cuts of 50 or more

<sup>1</sup>Consumers Union, the nonprofit publisher of *Consumer Reports*, is an expert, independent organization whose mission is to work for a fair, just, and safe marketplace for all consumers and to empower consumers to protect themselves. To achieve this mission, we test, inform, and protect. To maintain our independence and impartiality, Consumers Union accepts no outside advertising, no free test samples, and has no agenda other than the interests of consumers. Consumers Union supports itself through the sale of our information products and services, individual contributions, and a few noncommercial grants.

people by a single employer—are at their highest since continuous tracking began in April 1995, according to the U.S. Department of Labor.

The bleak employment picture contributes to severe financial distress for families and individuals throughout the country. According to *Economy.com*, 15 million home-owning households are “under water,” meaning that the owners’ mortgage balance is higher—often considerably higher—than the value of the homes.<sup>2</sup> As many as 3.5 million families may lose their homes to foreclosure this year,<sup>3</sup> and Consumers Union estimates that every 13 seconds, another home goes into foreclosure. Home equity loan and credit card delinquency rates were at record levels in the first quarter of the year, and tens of millions of households are struggling with bills they can’t pay.

When the economy falters, it’s prime time for ploys that claim to help consumers out of money messes. Unfortunately, as Linda Stern of Reuters has written, “. . . stocks and bonds might be down and out, but there is a bull market in cons.”<sup>4</sup> Consumers are at risk for a variety of get-rich-quick schemes and financial cons that target them specifically because they need fast help and/or are increasingly desperate. While many such frauds exist in both good times and bad times, the con artists expand their marketing efforts in recessions, and come up with very clever angles to attract new victims.

### Five Types of Recession-Oriented Financial Scams

In March 2009, *Consumer Reports* published “Financial Traps are Flourishing,” an article that profiles five types of costly financial traps that prey on financially-distressed consumers in troubled times.<sup>5</sup> A common theme of these consumer rip-offs is that “their financial fine print could leave [consumers] in worse shape than before.” Here are some examples of how financially-stressed households are affected by these practices.

#### 1. Foreclosure Rescue Scams

First-time homeowners Kari and Roger Mizer of Springfield, Ill., faced foreclosure on their home in 2007 after the monthly payment on their adjustable-rate mortgage hit \$1,850. It was just \$900 when they bought their house 2 years earlier.

Frustrated after being turned down for refinancing by more than 40 lenders, the Mizers had hope when they received a letter from a mortgage-restructuring firm that claimed to have a 95.5 percent success rate in stopping foreclosures. “As a member of the Better Business Bureau, you can trust us and avoid numerous dishonest scams,” said a letter they say they received from Augustus, Rae and Reed, based in St. Marys, PA.

The Mizers checked with the Better Business Bureau and found no complaints. So the couple said they tapped Roger’s 401(k) retirement plan in May 2007 to pay the firm’s up-front fees of \$1,347.

“They told us we shouldn’t communicate with the mortgage company anymore because they would do that instead and work out a repayment plan to save our house,” says Kari Mizer, a school food-service worker. When she began getting calls a month later from the mortgage lender about foreclosure proceedings, she was told that the firm had never contacted the bank. The Mizers’ home was put up for sale by the court around Christmas 2007 and auctioned off. They are now renting a house.

“All of the people who we talked to about refinancing or finding some way to keep our home acted like it was no big deal, that it’s just a house after all. But this was our home, and I cried for days because losing it was like going through a death in the family,” Kari Mizer says. The Mizers’ experience with a “rescuer” that charges an up-front fee for help that never comes is a common foreclosure-prevention trap. In fact the Mizers were among more than 200 Illinois consumers cited in a complaint against Augustus, Rae and Reed filed by Illinois Attorney General Lisa Madigan in September 2008.

The complaint contends that the firm violated state law by charging for services that it did not provide, in many cases failing to negotiate at all or simply submitting paperwork that consumers easily could have provided themselves. The state is seeking the return of fees and the imposition of penalties. In other cases, homeowners are pressed into signing documents that transfer the title of their home to the scammer.

<sup>2</sup>Nocera, Joe. “From Treasury to Banks, An Ultimatum on Mortgage Relief,” *The New York Times*, July 11, 2009.

<sup>3</sup>*Ibid.*

<sup>4</sup>Stern, Linda. “Personal Finance: Beware Scams and Sales Pitches,” *Reuters.com*, July 8, 2009.

<sup>5</sup>*Consumer Reports*. “Financial Traps are Flourishing,” March 2009.

Public notices of foreclosure proceedings usually trigger mail, phone, and even door-to-door solicitations. But consumers should steer clear of any company that initiates such contact, demands a fee before providing services, or advises cutting contact with the mortgage company. That can delay legitimate options for preventing foreclosure proceedings. If anyone asks for an up-front fee or payment of any kind for counseling, that's a signal that you're dealing with a possible pretender.

*What consumers should do:* Consumers anticipating problems making mortgage payments should seek legitimate free or low-cost help as soon as possible. Consumers can contact a housing counseling agency certified by the Department of Housing and Urban Development ([www.hud.gov/foreclosure](http://www.hud.gov/foreclosure) or 800-569-4287). Their agents can assess options and advise you in negotiating with the lender. Advice is also available at the Homeowner's Hope Hotline, at 888-995-4673 (see box below). Another good source of help is the Institute for Foreclosure Legal Assistance, [www.foreclosurelegalassistance.org](http://www.foreclosurelegalassistance.org), which funds and trains groups nationwide that give subsidized legal representation to families facing foreclosure.

*What policymakers and regulators can do:* With a projected 3.5 million mortgage foreclosures set to take place this year, the FTC's current and future investigative and enforcement work in this area is needed now more than ever. Consumers Union supports proposed state and Federal legislation that would prevent foreclosure rescue scams by creating additional protections for consumers who pay fees for rescue and loan modification services. In addition, Congress could pass legislation to create a Consumer Financial Protection Agency, which would meet a critical public need for stronger consumer protection in financial services, both by more carefully reviewing the financial products that are offered, and strengthening enforcement in response to consumer problems and complaints.

## 2. Hard-sell Reverse Mortgages

Helped along by television ads featuring actor James Garner and other celebrities, financial firms are enticing seniors to take equity out of their homes through reverse mortgages. Federally-insured reverse mortgages allow homeowners 62 and older to borrow against home equity and receive tax-free cash. The money borrowed plus interest is repaid only after the homeowner dies or moves out. The industry is expecting growth of these loans to accelerate since the lending limit has risen to \$417,000.

But a reverse mortgage should be a last resort. When homeowners use it to splurge on travel or pay off credit cards, they lose an important safety net that might be needed for an emergency. Lenders, though, are promoting a wide range of uses for reverse-mortgage cash. Financial Freedom Senior Funding Corp. of Irvine, Calif., suggests using the money for "special things you've always wanted to do, such as travel or hobbies." Financial Freedom is a subsidiary of IndyMac Bank, which was taken over by the Federal Deposit Insurance Corp. in 2008. A sale of IndyMac is pending.

The dangers are outlined in a lawsuit filed against Financial Freedom. The suit claims that the company advised its business partners to encourage seniors to take out as much money as possible in reverse mortgages so that the fees and interest paid to lenders would be maximized. The complaint goes on to say that Financial Freedom encouraged and trained partners, some of whom were insurance agents, to sell insurance products to seniors with the money gained from the reverse mortgage. In turn, Financial Freedom would obtain additional interest on the extra money borrowed.

The plaintiff, Betty Adcock, 80, says she was persuaded to replace her home equity line of credit with a reverse mortgage. Her daughter, Carol Anthony, had already helped her establish a \$150,000 no-fee home equity line for emergency expenses. During the first 3 years, Adcock had borrowed about \$19,000. But her daughter said at a December 2007 Senate Committee hearing that "in place of the no-fee home equity loan, she now had a reverse mortgage that charged 18 closing fees." The fees totaled a staggering \$16,791.23, Anthony said. The salesman, according to the suit, advised Adcock to choose a reverse mortgage payment option that required her to take out \$1,002.88 monthly, increasing the amount of interest she would have to pay. The suit claims that the reverse mortgage required that Adcock immediately make home repairs of about \$5,500 and pay Financial Freedom for monitoring whether the repairs were done. On the date the loan closed, she owed \$56,741.59. With the help of her daughter, Adcock paid off the reverse mortgage 6 months later at a final cost of \$71,942. Financial Freedom denies the allegations.

*What consumers should do:* *Consumer Reports* recommends that consumers considering tapping home equity can contact a HUD-approved counselor (800-569-4287 or [www.hud.gov/offices/hsg/sfh/hecm/hecmclist.cfm](http://www.hud.gov/offices/hsg/sfh/hecm/hecmclist.cfm)). A free session with a trained

counselor can help evaluate all of the choices. If you opt for a reverse mortgage, don't sign any documents until they have been reviewed by a lawyer you trust.

*What policymakers can do:* Consumers Union believes that sellers of reverse mortgages should be required to make sure the loan is suitable for the borrower, and that is one-on-one premortgage counseling for all reverse mortgages. There should also be caps on origination fees for all reverse mortgages and better restrictions on sales practices.

Senator Claire McCaskill has proposed legislation aimed at preventing fraud, and requiring that ads for government-backed mortgages present a balanced view of their risks and benefits. At her request, the GAO is conducting an ongoing investigation of the federally-insured mortgage program.

Legislation is currently pending in California that would extend requirements for beefed-up independent counseling and cross-selling restrictions to lenders who aren't federally-insured. Minnesota legislators supported a bill requiring lenders to show reasonable grounds for concluding that a reverse mortgage is suitable for each borrower, and Vermont has passed a law requiring face-to-face counseling.

### 3. High-fee Debt Settlement

Marissa Ruiz, 40, of Pasadena, Calif., was struggling to make minimum payments on more than \$10,000 worth of credit-card debt in May 2007 when she saw an online ad from Debt Settlement USA that persuaded her to sign up.

"They said they'd work with your creditors to reduce your total debt and get it all paid off, and that's what I wanted to do," says Ruiz, a single parent supporting four children, ages 11 to 17, on a modest income as a children's social worker. She says the company told her to stop sending payments to creditors, a tactic often used by debt-reduction companies. Instead she was supposed to save \$141.80 per month and tell Debt Settlement when she had at least \$1,000 so that the company could begin negotiating discounted payoffs with lenders.

The company deducted \$121.54 from her checking account as the first of 10 monthly payments required for fees, Ruiz says. She'd handed over more than \$600 by the time she quit the plan 5 months later because she believed she was getting nothing in return, other than being hounded by calls from bill collectors.

Debt Settlement USA's President, Jack Craven, says his company contacted Ruiz's creditors in July 2007 to notify them that she had granted the company limited power of attorney. He says she was not advised to stop paying creditors. Ruiz disputes that, and the written instructions she received from Debt Settlement state: "Do not speak to creditors." Ruiz says she contacted Debt Settlement to end its involvement. The company says that it tried to follow up but that she did not respond.

Ruiz then sought help from Clearpoint, a nonprofit financial-counseling agency that she had also spotted on the Internet. The credit counselor didn't require fees to help her develop a budget and contacted her creditors to discuss a realistic repayment plan. Ruiz says she negotiated directly with some lenders, such as Washington Mutual and JCPenney, that would agree to settle her bills for less than half of what she owed if she could pay the settlement amount in a few timely payments.

To earn the money to do that, she took on a part-time job. In one year, she slashed her debt from almost \$13,000 to \$3,000. "It hasn't been easy, and it still shocks me that I did it, but it feels great," Ruiz says. "Now when I hear ads on the radio all the time from these kind of companies, I get so angry because I don't want anyone else to get sucked in like I did." People using settlement companies could face problems in the time before debt negotiations usually begin. The original debt might soar as missed payments lead to penalty fees and other charges, and the credit rating plunges further.

Regulators say that under the typical arrangement, companies charge up-front fees totaling 15 percent of the debt to be settled, a monthly service fee of \$50 and if they do reach a settlement, a contingency fee of 20 percent or more of the amount they've allegedly saved. And the Internal Revenue Service might consider forgiven debt to be taxable income.

"Most consumers end up quitting these programs within the first 2 years after being subjected to constant collection calls and paying fees that can run into the thousands while receiving none of the benefits they were promised," says Googel, the Assistant Attorney General in West Virginia.

Wesley Young, Legislative Director of the Association of Settlement Companies, a trade group, says that 40 to 55 percent of consumers complete the programs but that lack of savings discipline is the most significant factor in the dropout rate. But in a May 2004 case against debt-settlement services brought by the Federal Trade Commission, a court found that less than 2 percent of consumers enrolled in the defendants' debt-negotiation programs, 638 out of 44,844, completed them.

In the past 2 years, West Virginia has charged nine debt-relief companies with violating state law by charging excessive fees for their services, along with other violations. The companies agreed to stop doing business with West Virginia residents and to refund \$735,000 in payments collected from 490 residents.

*What consumers should do:* Consumers struggling with credit-card debt should first consider negotiating directly with creditors. “Now is a better time than ever before to do this because card issuers are finally realizing that if we, their customers, go under, they will go down with us,” says Curtis Arnold, founder of *CardRatings.com*, a site that evaluates credit cards. “So they are reaching out to offer repayment plans to card members carrying significant debt loads.” Chase Card Services spokeswoman Tanya Madison says Chase will negotiate with some debt-settlement companies at a cardholder’s request but will not offer more favorable terms than the customer would receive by negotiating directly with the bank. People needing help can find a nonprofit credit counselor through the National Foundation for Credit Counseling ([www.debtadvice.org](http://www.debtadvice.org)). Those counselors will divide a set monthly payment among creditors to pay off the balance in full over time at reduced interest rates. Based on financial circumstances, the service might be provided free or for set fees: an enrollment charge of no more than \$25 and a monthly fee of no more than \$50.

*What policymakers can do:* We urge the FTC to undertake a vigorous enforcement program against debt collection abuses, such as:

- Prohibiting debt collectors who pursue debts in court or in arbitration without evidence of the essential facts of the debt, or without holding any license required by state law. The FTC must require that no collection activity can commence without proof of indebtedness by the consumer, date of the debt, identity of the original creditor, itemization of all fees, charges and payments, and itemization of all post-default charges and credits.
- Stopping debt collectors’ attempts to collect on time-barred debts, deceptive settlement agreements, putting old debt on new credit cards, and cross-debt collection by refund anticipation lenders.
- Restricting debt collectors from accessing a consumer’s financial account. At a minimum, there should be a requirement for express, informed, written permission.

With respect to debt settlement companies, the FTC’s own workshop showed that these services often don’t benefit the consumers who pay for them. H.R. 2309 would direct the FTC to consider issuing regulations in the area of debt settlement. The FTC should ban the charging of advance fees in debt settlement and cap fees based solely on a low percentage of the amount by which the debt is actually and permanently reduced below the amount owed when the debt settlement contract was first signed.

#### 4. A Credit Card for Anyone

The pitch sounds alluring: “If you have been turned down for credit recently because of your credit score, Continental Finance is here to help you with the second chance you have been waiting for.”

But the “second chance” provided by Continental Finance Classic MasterCard could cause cardholders’ credit scores to dive further. Designed for borrowers with subprime credit, commonly defined as a credit score below 660, the card comes with fees galore. The initial credit limit is \$300, but it is immediately reduced by a \$50 annual fee and a \$200 account-processing fee, leaving available credit of only \$50 at the outset. In addition, there’s a monthly account-maintenance fee of \$15, a \$5 fee for online payments, a \$25 fee if the credit line is increased, which can happen after 6 months, a \$15 replacement fee if the card is lost or stolen, and a \$35 over-the-limit fee. The annual interest rate on balances: 19.92 percent.

Issued by First Bank of Delaware, Continental Finance cards are among those labeled “fee harvester” credit cards in a 2007 report issued by the nonprofit National Consumer Law Center.

In late 2008, First Bank of Delaware agreed to pay \$304,000 in penalties and to overhaul procedures to settle charges filed in June 2008 by the FDIC. The complaint said that marketing for Continental Finance MasterCards issued from March 2006 through June 2008 and other cards issued by the bank failed to adequately disclose significant up-front fees and misrepresented what the consumers’ initial available credit would be.

CompuCredit, an Atlanta financial services and marketing company, was also named in the complaint. CompuCredit was First Bank of Delaware’s partner in marketing and servicing cards issued under other brand names such as Imagine MasterCard. Filings with the Securities and Exchange Commission show how lucra-

tive the credit-card business is. In 2007, CompuCredit reaped \$673.9 million in credit-card fees, up from \$436.7 million in 2006. Under CompuCredit's 2008 settlement with the FDIC, the company has agreed to reverse \$114 million in fees charged to consumer accounts arising from deceptive marketing allegations. The company also will pay a \$2.4 million civil penalty.

The FDIC order requires that the company disclose information about fees and other restrictions affecting available credit prominently on the same page in its solicitations. "No changes in our existing marketing materials are necessary because in 2006 we made changes in our solicitations that address the agencies' concerns about placement of fee-disclosure information," says Tom Donahue, a CompuCredit spokesman. The Federal Reserve Board has approved new rules for credit cards that limit total security deposits and fees during the first 12 months to 50 percent of the initial credit limit.

*What consumers should do:* A better alternative for consumers seeking to rebuild poor credit histories is a secured credit card, which requires a cash deposit of at least \$200 to \$300 as collateral. The amount of cash deposited will typically be the initial credit limit. Making timely payments should boost the credit score, so look for a card that reports to the three major credit bureaus and has no application fee. Interest rates on such cards recently were in the mid-to-low teens, and annual fees should be no more than \$50.

#### 5. Uninsured Savings Accounts

In early December, when the average interest rate on one-year certificates of deposit offered by U.S. banks was hovering at 3.2 percent, an online bank's offer sounded enticing: rates of 5.5 to 6.5 percent on one-year CDs. The bank says its "Premium" CDs are for the investor who is "looking for an alternative to the low rates offered by most domestic banks" and a guaranteed rate of return to avoid market fluctuations.

That high rate might be "guaranteed," but there's no Federal guarantee backing the money you deposit. That's because the offer came from Millennium Bank in St. Vincent and the Grenadines, in the West Indies, and the bank is not FDIC-insured. Millennium says it is a wholly-owned subsidiary of United Trust of Switzerland and devotes space on its website to describing Swiss banking. It notes that "the main reason for Swiss Banking is to keep one's financial status private, protecting personal assets along with receiving a higher return."

Millennium encourages customers to use its secure online banking services, but it says there is no website providing information about United Trust of Switzerland because its "premier private clients" don't trust the security of public websites.

We checked with the Swiss Federal Banking Commission, which says that United Trust is registered as a management-consulting firm and that neither it nor Millennium Bank is supervised by the commission. The International Financial Services Authority in St. Vincent confirms that Millennium is registered as an offshore bank operating on the island but would not comment further.

When we asked Millennium employee Bob Kelty how the bank invested depositors' money to achieve such high returns, he declined to explain, saying, "That's proprietary information."

*What consumers should do:* Some CDs, money-market accounts, and other savings alternatives might not be FDIC-insured, so you need to be careful and shop around. *Bankrate.com*, which publishes online bank data, lists federally-insured banks, along with a "Safe & Sound" rating assessing overall financial stability.

#### Recession-Related Internet Scams

Another big category of consumer frauds that target financially-distressed households are Internet-related scams relating to employment and work, including: (1) job search services; (2) unemployment benefits scams; (3) work-at-home schemes; and (4) websites that promise access to government grants; and (5) online shopping dangers.

##### 1. Internet Employment Scams

In our June 2009 magazine, in an article entitled "Boom Time for Cybercrime," *Consumer Reports* warns consumers to be especially careful about cyber-crimes during the economic downturn.<sup>6</sup>

According to the article:

One in five online consumers were victims of a cybercrime in the past 2 years, according to the latest *Consumer Reports* state of the Net survey. . . . The overall rate of cybercrime hasn't declined much over the 5 years we've tracked it.

<sup>6</sup> *Consumer Reports*, "State of the Net: Boom Time for Cybercrime," June 2009, p. 18–21.

Crooks continue to take advantage of new technologies. And consumers, corporations and the government haven't done all they could for protection. The problem stands to get worse as rising unemployment and foreclosures fuel a wave of recession-oriented Internet scams.

The article profiles Dan and Pat Quigley, a couple from Woodinville, Washington. When Dan was laid off from his engineering job with Motorola, he posted his résumé on several major job-search sites, entering personal data such as his name, address, and educational background. He didn't want to leave anything out, but he also worried that "with that info up there, I was essentially painting a target on myself." And soon, Dan began receiving a lot more employment-related spam.

Trying to help in her husband's job search, Pat Quigley visited a legitimate-looking site that promised jobs, but it turned out to be malicious. Then the Quigleys noticed that Pat could no longer access security software sites. Her computer had become infected. Ultimately, the couple was forced to erase Pat's hard drive.

According to Washington State's Attorney General, the Quigleys aren't alone.

"We've seen a big spike in complaints about work-related scams, and they're often over the Internet," Rob McKenna, Washington State's Attorney General told *Consumer Reports*. "What unemployed people, people in foreclosure, and the elderly all have in common is that they're more vulnerable, more anxious, and they set aside common sense."

Job scams come in a variety of guises, according to the Internet Crime Complaint Center, a partnership between the FBI, the Bureau of Justice Assistance, and the National White Collar Crime Center.

Some scams appear to be offers to process payments, transfer funds, or reship products but are actually fronts for operations that cash fraudulent checks, transfer illegally obtained funds, or receive stolen merchandise for shipment to criminals. Even users of well-known employment sites can be at risk. User IDs and passwords were recently stolen from the internal databases of job sites Monster and USAJobs.

*What consumers can do:* Avoid job listings that ask you to pay money up front. Make sure that online job-search services you use offer privacy options. Monster, for example, lets you post a confidential version of your résumé that hides your key contact information, among other things. Never post a résumé that includes your Social Security number. Avoid job offers that claim to pay a lot of money for little work.

## 2. Unemployment Benefit Scams

Some Internet frauds directly target the unemployed themselves. Michigan's Unemployment Insurance Agency has warned unemployed workers against using websites that charge fees to file their claims for unemployment benefits, and to be wary of e-mails inviting them to establish direct deposit accounts for their benefits. These "file-for-a-fee" and direct deposit services ask for personal information, exposing users to the risks of identity theft. The filing sites advertise on search engines such as Yahoo and Google, and appear as sponsored-ad listings when individuals search for information on how to file for benefits.<sup>7</sup>

*What consumers can do:* Bypass the scam offers, and file for unemployment benefits directly with the state agency that is responsible for distributing benefits.

## 3. Work-At-Home Schemes

The FTC has gone after at least 500 work-at-home schemes in recent years, and Internet ads for such services are rampant on the web. Such ads include ads for services that have generated many consumer complaints to the Better Business Bureau, the FTC and state consumer protection agencies.<sup>8</sup>

*What consumers can do:* It is possible for consumers to work at home—but deceptive offers are plentiful, so consumers shouldn't expect to get rich quick. To avoid scams, the Federal Trade Commission and NASE advise consumers:

- *Don't pay for materials*—Legitimate home product-assembly businesses are local and never ask you to buy the materials.
- *Be wary of network building*—Stay away from multilevel marketing schemes that make earnings contingent on your ability to sign up an ever-growing pyramid of "distributors" who are supposed to do the same and pass sales commissions up the line.
- *Do some sleuthing*—Check the company's Better Business Bureau rating. Also do a search at [www.ripoffreport.com](http://www.ripoffreport.com) and [www.complaints.com](http://www.complaints.com).

<sup>7</sup> WLKM News, Detroit, MI, June 16, 2009.

<sup>8</sup> *Consumer Reports*. "Beware of Work-At-Home Stings," June 2009, p. 15.



- *Be a skeptic*—Don't depend on promises of 100 percent satisfaction and money-back guarantees. They might be worthless.

#### 4. "Free Government Grants"

Numerous web ads claim that large sums of government money are available to consumers. If you fall for them, you will likely be enrolled in a grant-search program that could cost up to \$90 a month.

"Billions of dollars available in government grants, never repay!" claimed an ad recently at *FreshGrants.com*. The ad is an enticement for a "Free Grants Kit" that the website claims will explain how to apply for government grants for which you may or may not be eligible.

As for "free," that's open to interpretation. You're asked to provide your credit-card info to pay \$1.98 for shipping and handling. By ordering the "free" grant kit, you're agreeing to pay fees for monthly access to Grant Funding Search and a trial membership in the Ideal Wealth Builder Club, which includes benefits that "will show you how to turn your debt into wealth." But the ad's fine print said that if you didn't cancel within the free trial period, your credit card would automatically be charged \$99.90 in combined membership fees every month. That's how to build wealth, all right, just not for you.

At one such website, consumers were invited to fill out a brief form asking for their name, income, and the type of grant they are seeking.<sup>9</sup> A researcher from *Consumer Reports Webwatch* filled out the form several times in March, and received the same answer every time:

"Congratulations! You qualify for a free CD (compact disc)! Use this CD to apply for your cash: \$150 billion to start your own business! \$97 billion to go to school! \$144 billion to buy a home!"

While the CD is free, there's a \$3.95 shipping charge. But what probably isn't apparent to cash-strapped consumers desperately scouring the Web for financial aid is the fine print at the bottom of the page (below the screen), which reads as follows:

"Special Bonus: Order your FREE CD today and receive a free 7 day trial enrollment in the Grant Writing Express Online Help Center which includes 24 Hour E-mail Access to Grant Specialists, Funding Instruction Courses, and Grant Sources Updated Daily. It also gives you access to our Grant Writing Specialists who are there to Quickly Answer Your Questions about the Grant Process. *This membership continues at the low monthly rate of only \$74.95 for as long as you need the help in your Grant Search and Application Process. You can stop your monthly subscription to the help center site anytime in the 7 days and you will not be billed anything. The free trial begins on the day the CD is ordered.*"

The FTC has been warning consumers about scam government grant sites at least since 2006, and the Better Business Bureau has received many complaints about these sites. The sites may operate under literally dozens of similar business names; one website had as many as 30 different business names, acting as "feeder sites" to drive more web traffic to the primary company.

*What consumers should do:* Avoid website offers that offer easy money from government grants, and instead visit *www.Grants.gov*, the Federal Government's gateway to funding opportunities.

#### 5. Online Shopping Dangers

An estimated 1.7 million households were victims of ID theft committed over the Internet, *Consumer Reports'* State of the Net survey shows. Of the respondents to our survey who fell into that category, two-thirds said the incident occurred because of an online purchase. Other sources of ID theft included hacked computers, e-mail scams, and compromised financial transactions.

In 2008, the Consumer Sentinel Network, a joint project that includes the Federal Trade Commission, National Fraud Information Center, Internet Crime Complaint Center, and some Better Business Bureaus, reported 370,000 consumer-fraud complaints. In 63 percent of those, the defrauders, which include a variety of businesses, initially made contact with the consumer via the Internet.

<sup>9</sup>The Un-sponsored Link (blog), *Consumer Reports Webwatch*, available at:  
[http://blog.consumerwebwatch.org/2009/05/free\\_grant\\_moneya\\_sham\\_site\\_fr.html](http://blog.consumerwebwatch.org/2009/05/free_grant_moneya_sham_site_fr.html),  
<http://blog.consumerwebwatch.org/2009/05/governmentgrantsonlineusanother.html>,  
[http://blog.consumerwebwatch.org/2009/03/no\\_free\\_government\\_grants\\_at\\_g.html](http://blog.consumerwebwatch.org/2009/03/no_free_government_grants_at_g.html), and  
[http://blog.consumerwebwatch.org/2009/05/stay\\_away\\_from\\_all\\_grant\\_instr\\_1.html](http://blog.consumerwebwatch.org/2009/05/stay_away_from_all_grant_instr_1.html).

*What consumers can do:* Be cautious about with whom you do business. “Someone can set up an e-commerce site in hours,” says Brent Remai, Vice President of Consumer Marketing for security software maker McAfee. “And even if a site isn’t set up by a cybercriminal, it can be hacked.” Even when shopping at a site that seems trustworthy, first check it out with the Better Business Bureau’s online division. Consider using a two-way firewall, which blocks software that’s on your computer from sending outgoing communications without your knowledge. You can get one free of charge at [www.zonealarm.com](http://www.zonealarm.com).

*What regulators and policymakers can do about recession-oriented Internet-oriented scams:* Recession-oriented Internet fraud and scams do not exist in a vacuum, but are part of a much larger policy challenge reducing Internet-oriented scams, fraud and crime. We have three major recommendations:

1. Many of the scams identified above are promoted extensively through online advertising and e-mail, or through fraudulent shopping sites. This underscores the importance of swift enforcement and regular sweeps to detect and alert the public to problems, as have been carried out by the FTC and state regulators on various Internet issues.

Internet criminals can pivot on a dime to adjust their messaging to fit an economic downturn, a swine flu epidemic, or other crisis. Especially when economic times are hard, it is critical that state and Federal consumer protection agencies be provided with ample staff and investigative resources to go after purveyors of fraud, and widely communicate the results of their investigations to the public.

The FTC’s Operation Short Change, announced on July 1, is a prominent example of how a high-profile enforcement sweep can expose bad practices, directly halt the operations of specific companies, and send a clear message that such crimes will not be tolerated. In the states, many attorneys general have been active in warning the public about Internet scams and pursuing companies engaged in foreclosure scams and questionable debt settlement practices.

2. Media and Internet companies that accept advertising should carefully scrutinize advertisements for products or services that make unsupported promises, take advantage of financially-stressed consumers, or make unfair, unethical or questionable claims. While we don’t know what the exact standard should be here, we would note that as a matter of corporate responsibility, companies that accept advertising should not be setting consumers up for financial heartbreak.

As noted by Dr. George Blackburn in an FTC staff report regarding weight loss claims, “In the absence of laws and regulations to protect the public against dangerous or misleading products, a priority exists for the media to willingly ascribe to the highest advertising standards, *i.e.*, those that reject the creation and acceptance of advertisements that contain false or misleading weight loss claims.”<sup>10</sup>

We would also note that to their credit, some Internet search companies now specifically warn consumers about websites that could include spyware or malware. These companies may be able to do much more to suppress deceptive ads, and warn consumers against financial scam websites that put them at serious risk, and/or receive failing grades from watchdog groups and government regulators.

3. Consumers Union believes a variety of other new protections to prevent fraud and promote data security are needed, including measures to prevent retail fraud and protect sensitive customer data from security breaches. Businesses should store sensitive data in encrypted form. Two-factor user authentication, using a password and a key with a constantly updated passcode, would provide further protection. Companies should regularly test the security of their Web applications and networks. Programmers should be educated about the latest security measures. Companies entrusted with valuable consumer information should be certified by Trustkeeper and Verisign. Web-hosting companies must tighten policies to fight phishing, including suspending terms-of-service violators and requiring the collection of accurate information about account holders, as the Anti-Phishing Working Group suggests.

## Conclusion

Mr. Chairman, Members of the Committee, as outlined above, the diverse financial come-on and ripoffs come in a variety of forms and permutations, and unfortu-

<sup>10</sup>Cleland, R.L., *et al.*, “Weight Loss Advertising: An Analysis of Current Trends,” A Report of the Staff of the Federal Trade Commission, September 2002, page v.

nately do not lend themselves to a one-size-fits-all, silver bullet solution. However, we believe that given the risks to consumers, everyone must do more:

- Consumers must be ever on their guard, and very, very skeptical of offers of financial help and extra income, particularly when those offers come from businesses they don't know, or have an unfamiliar track record. They should seek second opinions and advice from knowledgeable and respected sources of information, including trusted friends, consumer protection agencies and watchdog groups, government agencies, attorneys, homeownership counselors and others, prior to handing over cash, or signing contracts or agreements that obligate them financially.
- Businesses that sell products with high fees or financial traps built into them should withdraw or redesign such products, or in other cases provide much better disclosure, counseling and protections for customers. In addition, businesses have an important role to play in strengthening the protection of sensitive customer information, to prevent security breaches and identity theft.
- Media and Internet companies that accept advertising should carefully scrutinize advertisements for products or services that make unsupported promises, take advantage of financially-stressed consumers, or make unfair, unethical or questionable claims. As a matter of corporate responsibility, companies that accept advertising should not be setting consumers up for financial heartbreak. To their credit, some Internet search companies now specifically warn consumers about websites that could include spyware or malware. These companies may be able to do much more to reduce and suppress deceptive ads, and warn consumers against financial scam websites that receive failing grades from watchdog groups and government regulators.
- State and Federal regulators should step up enforcement of companies that deceive and defraud consumers, and impose sharp criminal and civil penalties for companies that violate the law.
- State and Federal policymakers should consider new consumer protections to protect consumers against unfair and deceptive practices that target financially-distressed households. In particular, legislation pending before Congress to establish a Consumer Financial Protection Agency would greatly help to protect consumers in good times and bad, and ensure that laws against deceptive practices and fraud are effectively enforced.
- Economic fraud has a high financial and personal cost for consumers, could undermine public confidence in the marketplace and a renewed economy. Consumer protection should be a pillar of economic reconstruction, to ensure that people who work hard and save for the future will not be unfairly deprived of their income and assets.

Thank you very much for the opportunity to testify here today about this critically important national issue. We look forward to working with you as you move forward in addressing these issues.

Senator PRYOR. Thank you.

Next is Sally Greenberg, Executive Director of the National Consumer League.

**STATEMENT OF SALLY GREENBERG, EXECUTIVE DIRECTOR,  
NATIONAL CONSUMERS LEAGUE**

Ms. GREENBERG. Thank you, Senator Pryor. I'm really honored to be here this morning. First of all, thank you for holding this hearing. It's a really important topic, and your—you and your excellent staff have given all of us here an opportunity to make some recommendations and describe what we see out there. And it's not pretty.

One thing I've learned in this job—and I've only been at the job a couple of years; I was a colleague of Chuck Bell, here, at Consumers Union, for 10 years, before coming to the National Consumers League—is that those who perpetrate fraud have absolutely no qualms about stealing from the most desperate or destitute consumer. The consumers who fall into these fraudulent traps are not

stupid people. People tell me that all the time, “How can he be so stupid?” Well, I’ll tell you, the people who—Mr. Vitale, here—they’re very, very good at what they do, and they say all the right things to people, and they’re very schooled at it. So, I think it’s—the public education and outreach is just such an important piece of what we’re talking about here today, because once people hear the kinds of things that we’re talking about, I think they’ll think twice.

But, desperate times and tough economies, really make consumers much more vulnerable. We have certainly found that at the National Consumers League Fraud Center. The Fraud Center’s been going since 1992. It was really formed—we put it together as a result of this, just, explosion of Internet fraud. And what we saw in the last 6 months at the Fraud Center, the first 6 months of 2009, were 6,800 reports of fraud directly from consumers. We share all of those reports with 90 international, Federal, State, and local law enforcement officials. We particularly—we are very interested in bringing together both law enforcement, consumer organizations, labor groups, corporations, nonprofits, and government. We have something called an “Alliance Against Fraud,” and we’re going to make a recommendation that we all need to be talking together on a regular basis and more frequently.

Today, we’re pleased to be able to share with you the results of our 6-month review of complaints received by the Fraud Center, which covers the period, as I said, January to June of 2009. Of special note, work-at-home scams moved into our top-ten categories of most prevalent frauds. They didn’t make the top-ten list last year. Also, most of the frauds that we—that were reported to our Fraud Center were fake-check complaints. More than half involved either fraudulent mystery shopping opportunities or false sweepstakes winnings, with average losses of \$3,000-per-victim. We believe that both types of fraud are closely linked with the current economic circumstances. And moreover, in the last 6 months our statistics show the overall frequency of fake-check complaints has increased 4 percent.

The examples of consumers who have been scammed—we heard one very compelling woman speak about her example. What—we talked recently to a woman named Roxanne. I think her experience is illustrative. After receiving an advertisement for a mystery shopper job, Roxanne received a cashier’s check in the amount of \$4,665 in the mail. She promptly deposited the check, and, 3 days later, asked her bank to verify that it was good. And they did so. She began conducting her mystery shopping work that was assigned to her. Now, after purchasing several hundred dollars worth of items, Roxanne was instructed to wire the remainder of the funds left from the cashier’s check to clients in Canada. She learned, several days later, that the original cashier’s check had been returned to the bank as counterfeit. Unable to contact the representative, she was left owing the bank more than \$4,000. That’s a classic fake-check scam, and that—those have simply exploded over the last couple of years.

Her case illustrates that the worsening economy has caused increasing—increased consumer interest in supplementing their de-

clining incomes with work-from-home scams, and she's certainly not alone.

We conducted a survey in February of this year and found that 31 percent of respondents were more likely to consider starting a home-based business due to the worsening economic climate. That same survey found that 33 percent of respondents were unable to detect a pyramid scheme when it was described to them. And this trend was particularly pronounced among African Americans, Hispanics, and low-income consumers.

Adding insult to injury is what's going on out there in the rest of the country, because so many of the consumer offices around the country have been either slashed—their budgets have been slashed or they've been closed down entirely. From Florida to Wisconsin to Nevada to California, these offices are going without directors and they're—these offices are really the boots-on-the-ground protection that consumers have.

Now, we recommend—we're making five recommendations in our testimony. The first is in support of the great work the FTC is doing now. We want to point out, the FTC staff is only 63 percent of the size it was in 1979, and we want to ask you, as Members of Congress, to give the FTC and other Federal agencies the resources they need to do the job that so badly needs being done with their—the kind of outreach that we saw here this morning.

We would also like consumers to have the access to the FTC's Consumer Sentinel Database so they can quickly search it for complaints related to suspicious e-mails, telemarketing calls, and fraudulent businesses. Currently, only law enforcement has access. We think it's for privacy reasons. But, we would like to try to get that worked out so the public can get access to that information.

Third, we'd like to see low-income and minority consumers really the focus of our—of more efforts to protect them, since they tend to be the more vulnerable, especially in this economy. And we have—make some suggestions about reaching out to those who have applied for unemployment benefits. There's also work that could be done for those who are accessing different programs that the FTC has for people who need assistance in both Internet and landlines.

So, we—with financial support from Congress, we also would like to ask that the FTC create a grant program for organizations from State and local government, and nonprofits, to help fund innovative consumer fraud projects.

And last, we would like to see, as I noted before, more coordination with all the Federal agencies that do the kind of work that all of us here at the table do. We think there should be a more regular coming together of all of us, perhaps a national conference, to talk about antifraud strategies.

So, thank you, Mr. Chairman, for giving the National Consumers League this opportunity to talk with you today. We commend you for focusing on this rampant consumer fraud, and we thank you, also, for your very pro-consumer record.

[The prepared statement of Ms. Greenberg follows:]

PREPARED STATEMENT OF SALLY GREENBERG,  
EXECUTIVE DIRECTOR, NATIONAL CONSUMERS LEAGUE

### Introduction

Good morning, Mr. Chairman, and members of the Subcommittee. My name is Sally Greenberg and I am the Executive Director of the National Consumers League (NCL).<sup>1</sup> I appreciate this opportunity to appear before the Subcommittee on Consumer Protection, Product Safety, and Insurance of the Senate Commerce, Science, and Transportation Committee to discuss the issue of fraud connected to the ongoing economic recession.

Since our founding more than a century ago, the National Consumers League has sought to protect consumers from fraudulent practices. In 1992, the League established a Fraud Center, enabling us to directly assist consumers threatened by the rampant proliferation of telemarketing and online fraud enabled by the growth of global telecommunications networks and the Internet. Via our online fraud information portal, *Fraud.org*, we accept consumer fraud complaints which we analyze and share with more than ninety international, Federal, state, and local law enforcement and consumer protection agency partners including the Federal Trade Commission (FTC), Federal Bureau of Investigation (FBI), and U.S. Postal Inspection Service (USPIS). Thanks to the work of the Fraud Center staff, NCL was one of the first organizations to raise the alarms about the growth in fake-check scams, which now account for more than forty percent of the nearly fifteen thousand complaints NCL receives on an annual basis.<sup>2</sup> Today, we are pleased to be able to share with you the results of our six-month review of fraud complaints received by the Fraud Center, covering the period January–June of 2009. Through our Alliance Against Fraud coalition, NCL also acts as a convener of thirty-nine organizations from the non-profit, corporate, government, and labor communities to coordinate anti-fraud activities nationally.

The impact of fraud nationally is stunning. According to FTC estimates, 30.2 million consumers were victims of fraud in a single year.<sup>3</sup> The impact of fraud on businesses is equally staggering. According to the Association of Certified Fraud Examiners, a 50,000 member professional organization, it is estimated that fraud costs organizations approximately 7 percent of annual organizations revenues, or approximately \$994 billion annually.<sup>4</sup> Given these sobering statistics, we believe it is imperative that public policymakers at all levels of government—and particularly at the Federal level—redouble their efforts to educate consumers about the threat of fraud and to vigorously enforce existing statutes and regulations pertaining to fraud.

### Fraud Linked to the Recession is a Growing Threat

Americans are clearly concerned about the link between the recession and consumer fraud. According to the Unisys Security Index, nearly three in four Americans believe that the world financial crisis will increase the risk of identity theft and fraud.<sup>5</sup> While detailed statistics are difficult to obtain, it is clear to us that rising economic hardship is affecting consumers' vulnerability to fraud. The story of one victim who contacted the Fraud Center—who we will call simply Roxanne to protect her privacy—is typical of the complaints we have increasingly received in recent months.

In hopes of finding work, Roxanne was grateful to be contacted by a company calling itself "Service Inspection," which was purportedly looking for mystery shoppers. After responding to the offer, Roxanne received a cashier's check in the amount of \$4,665 in the mail. The company representative encouraged Roxanne to begin work immediately. Roxanne deposited the check and after three business days contacted her bank to verify that funds were available. The bank assured her that the check had "cleared," and she began conducting the mystery-shopping work "assigned" her. After purchasing several hundred dollars worth of items from the Gap and Wal-Mart, she was instructed to wire the remainder of the funds left from the cashier's

<sup>1</sup>The National Consumers League, founded in 1899, is America's pioneer consumer organization. Our non-profit mission is to protect and promote social and economic justice for consumers and workers in the United States and abroad. For more information, visit [www.nclnet.org](http://www.nclnet.org).

<sup>2</sup>According to the FTC's *Consumer Sentinel Network Data Book for January–December 2008*, counterfeit check scams were the fifth-most reported scam, accounting for 3 percent of the total complaints received.

<sup>3</sup>Federal Trade Commission. *Consumer Fraud in the United States: The Second FTC Survey*. Pg S-1. October 2007. Online: <http://www.ftc.gov/opa/2007/10/fraud.pdf>.

<sup>4</sup>Association of Certified Fraud Examiners. *2008 Report to the Nation on Occupational Fraud and Abuse*. Page 4. July 14, 2008. Online: <http://www.acfe.com/documents/2008-rtnn.pdf>.

<sup>5</sup>Unisys Corporation. "Unisys research Shows Economic Crisis Causing Increased Worldwide Consumer Fears about Fraud and Security Risks," Press Release. April 20, 2009.

check to “clients” (in reality, associates of the scammer) in Canada via Western Union and MoneyGram. Several days later, Roxanne was informed by her bank that the original cashier’s check had been returned to the bank as counterfeit. Unable to contact the “Service Inspection” representative (who had likely already absconded with cash from the wire transfer), Roxanne was left owing her bank more than \$4,000.

The sequence of events in Roxanne’s story is not atypical. The majority of fake-check scam complaints our Fraud Center has received involve either fraudulent mystery-shopping “opportunities” or false sweepstakes “winnings.”<sup>6</sup> For the first 6 months of 2009, fake-check scams made up more than forty-four percent of the total complaints NCL received, of which sixty-five percent involved a fraudulent mystery shopper job or phony sweepstakes winnings, with average losses of more than \$3,000 per victim.<sup>7</sup> We believe that both types of fraud are closely linked with economic circumstances. The worsening economy has caused increased consumers interest in supplementing their declining incomes with work-from-home opportunities, in particular. NCL conducted a survey in February of this year and found that thirty-one percent of respondents were more likely to consider starting a home-based business due to the worsening economic climate.<sup>8</sup>

The impact of recession-related fraud is likely to fall disproportionately on low-income and minority consumers. As part of NCL’s February 2009 survey of consumer vulnerability to pyramid schemes, we sought to test whether consumers could differentiate a legitimate home-based multi-level marketing plan from a fraudulent pyramid scheme. We found that thirty-three percent of respondents were unable to detect the pyramid scheme when it was described to them. This trend was especially pronounced among African-American, Hispanic, and low-income consumers (48 percent, 35 percent, and 39 percent, respectively). Given that African-Americans (46 percent) and Hispanics (48 percent) were also more likely than average (31 percent) to consider a home-based business due to the economic recession, these populations are at increased risk of such fraud.<sup>9</sup>

Sweepstakes—many of which are fraudulent—also appeal to consumers faced with imminent home foreclosure or mounting household debt. Consumers may fall victim to the promise of unexpected riches as a way to stave off economic ruin. Fraud complaints involving such scams (but not including a fake check) have increased in the first 6 months of 2009 versus our 2008 year-end statistics. Other types of fraud linked to the bad economy are also on the rise. Fraudulent business opportunity scams (which includes fake franchises and distributorships) were not among the top ten types of scams reported to the Fraud Center in 2008. In the first 6 months of 2009, however, they have grown to be the sixth-most reported scam.<sup>10</sup> As the unemployment rate nears 10 percent, we expect more out-of-work consumers to explore the option of starting their own businesses, increasing their exposure and vulnerability to such business opportunity scams.

Mounting household debt is also fueling a dramatic rise in fraudulent credit counseling and credit repair services. The story of one such victim who contacted the Fraud Center—we’ll call her Patrice—is illustrative of these kind of scams. Patrice, anxious to repair her damaged credit, signed up online with a company going by the name of “Advanced Credit Systems” (ACS). The ACS “representative” claimed the company was able to “guarantee” its customers that it could repair their credit by working with lenders and via personalized credit counseling services. After speaking with the ACS “representative” several times by telephone, Patrice was instructed to make her first payment of \$1,200, which she promptly wired to a bank account specified by ACS. Immediately after Patrice transferred the funds, she attempted to contact ACS, only to find that the “representative” and ACS would no longer answer her increasingly frantic calls. Patrice never received any services in exchange for her \$1,200.

<sup>6</sup>For more information on fake-check scams, visit NCL’s and the Consumer Federation of America’s fake checks campaign website at [www.fakechecks.org](http://www.fakechecks.org).

<sup>7</sup>National Consumers League. Analysis of first 6 months of complaint data from NCL’s Fraud Center. July 9, 2009.

<sup>8</sup>National Consumers League. “National Consumers League 2009 Pyramid Scheme Survey: Key Findings,” February 2009. Online: [http://www.fraud.org/pyramids/survey\\_findings.pdf](http://www.fraud.org/pyramids/survey_findings.pdf).

<sup>9</sup>National Consumers League. “National Consumers League 2009 Pyramid Scheme Survey: Key Findings,” February 2009. Online: [http://www.fraud.org/pyramids/survey\\_findings.pdf](http://www.fraud.org/pyramids/survey_findings.pdf).

<sup>10</sup>National Consumers League. “NCL’s Fraud Center: Top 10 Scams of 2008.” June 2, 2009. Online: <http://www.nclnet.org/news/2009/2008%20fraud%20stats.pdf>.

### State and Local Budget Shortfalls Decimating Consumer Protection Capabilities

At the same time that consumer vulnerability to fraud has increased due to the economic recession, the abilities of those entrusted with protecting consumers from scam artists have been severely curtailed. While Federal agencies such as the FTC, FBI, USPS, and Office of the Comptroller of the Currency (OCC) perform a valuable job protecting consumers from scams falling under their purview, much of the day-to-day consumer protection work in the United States is performed at the state and local level. State and local consumer protection agencies, never a darling of appropriators even before the economic crisis, are now seeing their budgets cut to the bone or worse.

For example, the Nevada Consumer Affairs Division (NVCAD) has temporarily suspended all operations for FY2010. The NVCAD was responsible for accepting consumer complaints and bringing civil actions against scam artists in Nevada. There is currently no way for consumers to submit fraud complaints to state consumer protection officials in Nevada. The Wisconsin Department of Agriculture, Trade, and Consumer Protection has had to make due with significantly fewer employees in recent years and has been subject to Governor Doyle's request that some positions remain unfilled.<sup>11</sup> The California Department of Consumer Affairs has been without a Director for more than 3 months due to budget woes.

The Hillsborough County, Florida Consumer Protection Agency (whose area of jurisdiction encompasses the City of Tampa) may soon be eliminated.<sup>12</sup> In Virginia Beach, Virginia, a city whose population is in excess of 440,000, the director of the city's Consumer Affairs program recently resigned her position in an effort to save the agency from being closed down due to budget issues.<sup>13</sup> Pasco County, Florida, one of the top fifty fastest-growing counties in the Nation,<sup>14</sup> dissolved its Consumer Affairs Office to help make up for its budget shortfall. The 700 cases that the office took on annually will presumably also no longer be investigated.<sup>15</sup>

These are not isolated incidents. Across the country, state and local authorities are decimating consumer protection agencies' budgets in an effort to deal with large deficits. State and local consumer protection organizations are the proverbial "boots on the ground," in the fight to control fraud. Without action at the Federal level to step into the gap created by the demise of state and local-level consumer protection capabilities, consumers will increasingly be left to fend for themselves against the growing threat posed by professional fraudsters.

### Consumer Empowerment Must Be Paired With an Increased Federal Role

Consumers face a double bind. The economic crisis has made them increasingly vulnerable to fraud while local agencies that investigate scams and enforce the laws are shutting their doors, leaving consumers with fewer avenues to protect their interests. Absent increased action at the Federal level to investigate and prosecute scam artists and educate consumers about the threat of fraud, consumers will be caught between the proverbial rock and a hard place.

We cannot simply wait for the economy to turn around and state and local budgets to recover. The economic crisis is likely to remain with us for the foreseeable future. Experts predicted that any recovery in the U.S. economy in 2010 is likely to be modest.<sup>16</sup> We expect that this will mean continued belt-tightening for state and local governments with commensurate impacts on consumer protection agencies. Absent direct Federal support of state and local consumer protection efforts, consumers will need the Federal Government to play an increased role in protecting them from fraud. To this end, we propose the following remedies:

First, we must give the relevant Federal agencies the resources they need to protect consumers from fraud. In particular, the Federal Trade Commission remains a critically underfunded and overworked agency. While the FTC continues to fulfill its traditional antitrust enforcement and consumer protection missions, its portfolio has grown—largely thanks to the explosion in Internet-related fraud—to include implementation statutes related to identity theft, the CAN-SPAM Act, Do-Not-Call Reg-

<sup>11</sup>Jenkins, Janet. Administrator of DATCP Division of Trade and Consumer Protection. Telephone interview. July 9, 2009.

<sup>12</sup>Varian, Bill. "Hillsborough County budget cuts runs deep." *St. Petersburg Times*. June 4, 2009. Online: <http://www.tampabay.com/news/localgovernment/article1007144.ece>.

<sup>13</sup>Moore, Nancy. City of Virginia Beach Consumer Affairs Program. Telephone interview. July 10, 2009.

<sup>14</sup>U.S. Census Bureau. Online: <http://www.pascoedc.com/PascoCounty.aspx>.

<sup>15</sup>"Consumers will lose an advocate," *St. Petersburg Times*. June 19, 2008. Online: <http://www.tampabay.com/opinion/editorials/article631715.ece?comments=legacy#>.

<sup>16</sup>Reuters. "Recession likely to end in Q3 2009-Blue Chip survey," July 10, 2009. Online: <http://www.reuters.com/article/bondsNews/idUSN1051292120090710>.



istry, and USA SAFE WEB Act, among other areas. Despite this growing mission, the FTC's staff is only 63 percent of the size it was in 1979.<sup>17</sup> The lack of resources available to the FTC is perhaps best illustrated by the number of enforcement actions brought by the agency in recent years. For the twelve months ending February 2005, the FTC brought 83 enforcement actions. Every year since then, the number of actions brought by the agency has shrunk. For the twelve months ending February 2008, that number had dwindled to 23.<sup>18</sup> The FTC can and should do more to protect and educate consumers, but it will require additional resources to do so. Increasing FTC funding levels, particularly in the Bureau of Consumer Protection, to levels sufficient to meet the Commission's growing mission would be a good first step toward this goal.

Second, more resources for enforcement should be coupled with a renewed focus on consumer education and an embrace of innovative vehicles for empowering consumers to protect themselves from fraud. We would like consumers to have access to the FTC's Consumer Sentinel (CSN) database so that they can quickly search it for complaints related to suspicious e-mails, telemarketing calls, and fraudulent businesses. That database, which last year collected more than 1.2 million complaints and now contains over 7.2 million, could be an extremely valuable tool for consumers.<sup>19</sup> Currently, only law enforcement agencies who agree to strict non-disclosure requirements have access due in part to the availability of personally identifying information within the complaints.<sup>20</sup> We would urge the FTC to convene a series of meetings among its non-profit, law enforcement, and consumer protection agency partners to determine what information within the CSN database can safely be made publicly available and searchable for the benefit of all consumers.

Third, as detailed in our testimony, low-income and minority consumers have proven particularly vulnerable to fraud connected with the worsening economy. Special attention should be given to fraud education efforts aimed at these distinct populations. For example, recently-jobless consumers applying for unemployment benefits could be provided with educational information related to work-at-home scams and business opportunity fraud. New applicants for FCC and state-level Lifeline and Link-Up telecommunications subsidy programs could be provided with information related to Internet and telemarketing fraud. This could become particularly helpful as those and other subsidy programs connected to the Universal Service Fund transition from a landline telephone-based model to a broadband and wireless telephone-based model. These materials should be made available in multiple languages to assist non-English speaking consumers who may also be more vulnerable to these scams.

Fourth, the FTC should enhance its support of fraud education efforts undertaken by national, state, and local non-profit partners working with populations at enhanced risk of fraud via targeted grant-making. While government agencies are important, non-profit consumer groups and others play an important role in interacting with consumers. NCL talks weekly to hundreds of victims of scams. We consider ourselves to be partners with government agencies in fighting fraud. However, we have the advantage of being a consumer group and many people tell us they are more comfortable interacting with us than with a government agency. NCL—and likely other non-profit members of our Alliance Against Fraud—would like the opportunity to apply for government grants to expand our work on fraud and take on innovative anti-fraud projects. Much like what the Department of Justice does with its grants program to non-profits, the FTC could do with consumer protection groups.

Finally, while we support enhanced resources for Federal agencies to enforce fraud statutes and educate consumers, this is a shared responsibility with state and local government, business, and on-profit organizations. What is also needed is increased cooperation and goal-setting among the myriad Federal agencies that are active in addressing fraud within their organization's regulatory purview and these external stakeholders. Agencies like the FBI, FTC, SEC, USPIS, U.S. Secret Service,

<sup>17</sup> According to the FTC, the Commission had 1,746 FTEs in 1979 (see <http://www.ftc.gov/ftc/oed/fmo/fte2.htm>) and requested 1,102 FTEs in FY2009 (see <http://www.ftc.gov/ftc/oed/fmo/budgetsummary09.pdf>).

<sup>18</sup> According to FTC Annual Reports to Congress, the Commission brought 83 actions for the twelve months ending February 2005, 60 actions for the period ending February 2006, 59 actions for the period March 2007, and 23 for the period ending February 2008 (see <http://ftc.gov/os/annualreports/index.shtml>).

<sup>19</sup> Federal Trade Commission. *Consumer Sentinel Network Data Book for January-December 2008*. Pg 3. February 2009. Online: <http://www.ftc.gov/sentinel/reports/sentinel-annual-reports/sentinel-cy2008.pdf>.

<sup>20</sup> Complaint data from NCL's Fraud Center is periodically submitted to the Consumer Sentinel database as part of our partnership with the FTC.

State Department and Department of the Treasury all do excellent work and are experts at detecting and fighting back against the kinds of fraud affecting their areas of specialization. What is lacking is broad, sustained inter-agency coordination on anti-fraud work. This is one reason why NCL is strongly supporting the restoration of the White House Office of Consumer Affairs which NCL, along with other national consumer groups, have called upon the Obama Administration to create.<sup>21</sup> Such an office should be charged with organizing a coordinating conference among the Federal anti-fraud organizations, with input from consumer groups and other third-party stakeholders, aimed at developing a national anti-fraud strategy.

### **Conclusion**

In conclusion, the impacts of the economic crisis on consumers have been dire. Not a day passes without new stories of consumers losing jobs, homes, and retirement savings to the worsening economy. These disastrous effects are compounded by rampant consumer fraud. Economic hardship all-too-frequently leads to the kind of desperation that fraudsters prey upon, as our fraud statistics clearly indicate. Vulnerability to such scams is especially acute among those populations least able to recover from the impact of fraud.

The negative effects of the economic crisis on consumer fraud protection have been exacerbated by the decline—and in some cases the disappearance—of state and local consumer protection agencies. With fewer places to turn to within their communities, victims of fraud will increasingly look to the Federal Government to fill the void left by smaller state and local consumer protection budgets.

NCL believes we can and must do more to protect consumers from fraud in these trying economic times. We believe it is imperative that the Federal Government give its fraud protection agencies the resources they need to accomplish this growing mission. We strongly support efforts by Congress and the Executive Branch to investigate ways that Federal fraud protection can be enhanced by greater inter-agency coordination, greater outreach to at-risk populations, and innovative projects that empower consumers to protect themselves.

Thank you, Mr. Chairman, for giving the National Consumers League this opportunity to comment on the effect of the recession on consumer fraud. We commend you for your pro-consumer record and look forward to working with you and your staff to help protect America's consumers from the scourge of fraud.

Senator PRYOR. Our next witness will be Tim Muris, former FTC Chair, and now Professor at George Mason University School of Law.

### **STATEMENT OF TIMOTHY J. MURIS, FOUNDATION PROFESSOR, GEORGE MASON UNIVERSITY SCHOOL OF LAW AND OF COUNSEL, O'MELVENY & MYERS LLP**

Mr. MURIS. Thank you very much, Mr. Chairman.

I have held four positions at the FTC. I was Chairman from 2001 to 2004, and I am the only person ever to direct both of the agency's enforcement bureaus, fortunately not at the same time.

I strongly believe in the FTC as a consumer protection agency. I'm especially proud of our consumer protection accomplishments while I was Chairman. We did great work in the fraud program and in protecting the privacy of Americans, including creating the National Do Not Call Registry.

Preventing fraud is crucial of the Commission's mission. Fraud is essentially theft. Fraud distorts market forces and limits the ability of consumers to make informed choices. Fraud takes many forms and imposes enormous costs.

Fraud will largely go unchecked without the leadership of the Nation's Consumer Protection Agency. We created the FTC's modern antifraud program in 1981, when I directed the Bureau of Con-

<sup>21</sup>"Economic Security, Health and Safety of Nation," Press release. Consumer Federation of America *et al.* December 11, 2008. Online: <http://static.uspirg.org/consumer/archives/consumerreleaseandplatform10dec2008.pdf>.

sumer Protection. We used Section 13(b) to halt fraudulent schemes and to obtain consumer redress and other potent equitable remedies.

Once launched, the fraud program grew in importance and success. Each succeeding FTC Chairman has expanded its scope and improved its operation. While I was chairman, we greatly increased cooperation with criminal authorities, helping put bad actors in jail. Further, we expanded the FTC's consumer protection efforts to Spanish-language media. When I arrived, the FTC directed very little attention to marketing that appeared in any language other than English. We corrected the problem, and that effort continues.

I want to personally thank Senator Nelson, his staff and the Florida delegation helped us a lot with that effort.

The fraud program is at the heart of what I believe is the FTC's proper role. In America, we use markets to organize our economy. Consumers derive vast economic benefits over the long term from these markets. Consumer protection policy, in turn, can have profound effects, both for good and ill, on these markets.

The FTC and other public authorities operate against a backdrop of important consumer protection institutions; most notably, the market and private common law. In our economy, consumers compete to offer the most appealing mix of price and quality. But, when competition alone cannot punish or deter seller dishonestly, the common law provides basic rules of the road, such as "Don't lie to your customers," and "Keep your contractual promises."

Notwithstanding the strengths of the common law, sometimes, as when court enforcement is not feasible, private law just doesn't work. When market forces are inefficient and the common private law is ineffective, a public agency, such as the Federal Trade Commission, can help preserve competition and protect consumers. Thus, the FTC has a crucial role as an umpire in our economy, but it is not, and should not be, a star player.

Let me make a closely related point. As this committee considers the Commission's tools to attack fraud, there are proposals to expand the FTC's rulemaking authority. Although many do not think of them as such, the common-law principles I just discussed are rules, providing a crucial part of the institutional framework that helps our market economy function to protect consumers. In most circumstances, these common-law rules provide both clear guidance to the business community and an adequate basis for FTC enforcement. Although common-law rules do not provide for civil penalties, there is no need for such penalties to combat fraud. The FTC already has the authority to get the money through Section 13(b), as I just discussed, and the limit is the amount of money available, not any lack of authority.

Moreover, rules seeking to address fraudulent practices often are very difficult to write. By their nature, rules must apply to legitimate actors. Remedies and approaches that are appropriate for bad actors can be extremely burdensome when applied to legitimate businesses, and there is simply no straightforward way to write a rule against fraud.

Rulemaking should not be a substantial component of FTC consumer protection. The agency went down this road once before, with disastrous consequences. In the 1970s, the Commission em-

barked on a vast enterprise to transform the American economy. In 15 months, the Commission proposed 15 rules, usually without a clear theory of why there was a law violation, and, at best, a shaky empirical foundation. As it did before, the FTC will fail if it seeks to become the second most powerful legislature in Washington.

The procedures currently required for rules force the Commission to be clear about its theories and focus its evidence on the key questions. The ability of rulemaking participants to designate disputed factual issues and cross-examine witnesses on those issues is very useful in testing the Commission's theories. Properly focused, so-called Magnuson-Moss procedures are workable. They help the Commission create clear, targeted rules aimed at bad actors without harming legitimate businesses and consumers.

I would like to discuss, briefly, a final issue. From personal experience, those with whom we worked in Attorneys General offices across America are diligent and professional. Nevertheless, recent problems have arisen in a few states involving the outsourcing of enforcement. Some want to grant State Attorneys General greater authority to enforce Federal regulations. If you, in Congress, choose to extend such authority, you should add safeguards so that the authority is exercised in a uniform, transparent, and impartial manner.

Thank you very much, Mr. Chairman. I would be glad—and members of the Committee—I would be glad to answer any questions.

[The prepared statement of Mr. Muris follows:]

PREPARED STATEMENT OF TIMOTHY J. MURIS, FOUNDATION PROFESSOR, GEORGE MASON UNIVERSITY SCHOOL OF LAW AND OF COUNSEL, O'MELVENY & MYERS LLP

Chairman Pryor, Ranking Member Wicker, and Members of the distinguished Subcommittee, my name is Tim Muris. I am Foundation Professor at the George Mason University School of Law and of Counsel at O'Melveny & Myers LLP. Most relevant for today's hearing, I held four positions at the Federal Trade Commission, most recently as Chairman from 2001–2004. I am also the only person ever to direct both of the FTC's enforcement arms, the Bureau of Consumer Protection and the Bureau of Competition. I believe strongly in the importance of the FTC as a consumer protection agency. Serving as Chairman was the greatest honor of my professional career, and I am especially proud of our consumer protection accomplishments, such as our work on the fraud program and in protecting the privacy of Americans, including creation of the National Do Not Call Registry. The United States Chamber of Commerce and United States Chamber Institute for Legal Reform have asked me to discuss the important subjects of today's hearing, and I want to thank the Committee for giving me the opportunity to appear today. The views I express are my own.

#### **I. The Role of the FTC**

As a Nation, we use markets to organize and drive our economy. We derive vast economic benefits from these markets and the competition that helps markets function properly. These benefits should not be taken for granted; they are not immutable. The Nation's consumer protection policy can have profound effects on such benefits by strengthening the market. The policy also can reduce these benefits, however, by unduly intruding upon the market and hampering the competitive process. The Federal Trade Commission has a special responsibility to protect and speak for the competitive process, to combat practices that harm the market, and to advocate against policies that reduce competition's benefits to consumers.

The FTC protects consumers through its responsibility to prevent "unfair or deceptive acts or practices."<sup>1</sup> The FTC, and other public authorities, operate against a backdrop of other consumer protection institutions, most notably the market and

<sup>1</sup> 15 U.S.C. § 45.

private common law. In our economy, producers compete to offer the most appealing mix of price and quality. This competition spurs producers to meet consumer expectations because the market generally imposes strict discipline on sellers who disappoint consumers and thus lose sales to producers who better meet consumer needs. These same competitive pressures encourage producers to provide truthful information about their offerings. Market mechanisms cannot always effectively discipline deceptive sellers, however, especially when product attributes are difficult to evaluate or sellers are unconcerned about repeat business.

When competition alone cannot punish or deter seller dishonesty, another institution can mitigate these problems. Private legal rights provide a set of basic rules for interactions between producers and consumers, such as do not lie to your customers and keep your contractual promises. Government also can serve a useful role by providing default rules, which apply when parties do not specify rules. These rights and default rules alleviate some of the weaknesses in the market system by reducing the consequences to the buyer from a problematic exchange. Notwithstanding the strengths of private legal rights, in some circumstances—as when court enforcement is impractical or economically infeasible—they may not be an effective deterrent.

When consumers are vulnerable because market forces are insufficient and the common law is ineffective, a public agency, such as the Federal Trade Commission, can help preserve competition and protect consumers. The FTC's consumer protection and competition missions naturally complement each other by protecting consumers from fraud or deception without restricting their market choices or their ability to obtain truthful information about products or services. The Commission attacks conduct that undermines competition, impedes the exchange of accurate information, or otherwise violates the common law rules of exchange.

Because of its antitrust responsibilities, the agency is well aware that robust competition is the best, single means to protect consumers. Rivalry among incumbent producers, and the threat and fact of entry from new suppliers, fuels the contest to satisfy consumers. In competitive markets, firms prosper by surpassing their rivals. In turn, this competitive market has important implications for the design of consumer protection policies to regulate advertising and marketing practices.

Without a continual reminder of the benefits of competition, consumer protection programs can impose controls that ultimately diminish the very competition that increases consumer choice. Some consumer protection measures—even those motivated by the best of intentions—can create barriers to entry that limit the freedom of sellers to provide what consumers demand. While I was Chairman, for example, the Commission participated in a court challenge to a state law that banned anyone other than licensed funeral directors from selling caskets to members of the public over the Internet. While recognizing the state's intent to protect its consumers, the Commission questioned whether the law did more harm than good. In an amicus brief, the FTC noted that “[r]ather than protect[ing] consumers by exposing funeral directors to meaningful competition, the [law] protects funeral directors from facing any competition from third-party casket sellers.”<sup>2</sup> The synergy between protecting consumers from fraud or deception without unduly restricting their choices in the market or their ability to obtain truthful information should undergird all of the Commission's consumer protection initiatives.

## II. The FTC and Consumer Fraud

Preventing fraud is a crucial part of the Commission's support of the market system and the common law. More than half of the Commission's budget and staff is devoted to consumer protection, with a significant focus on fraud. Fraud is essentially theft. Fraud distorts market forces and limits the ability of consumers to make informed choices. Fraud leads to inefficiency, causing consumers to allocate their resources unproductively. Fraud also reduces consumer confidence and the efficacy of legitimate advertising, thereby further diluting the amount of useful information to guide consumers' choices. This effect also raises costs for legitimate competitors, who must offer more assurances of performance to overcome consumers' wariness.

The costs of fraud to consumers are enormous. Fraud takes many forms from fraudulent credit repair services, to unauthorized billing, to deceptive weight loss products. A survey released by the FTC in 2007 showed that an estimated 13.5 percent of U.S. adults, approximately 30.2 million consumers, were victims of one or

<sup>2</sup>Memorandum of Law of *Amicus Curiae* Federal Trade Commission, *Powers v. Harris*, Case No. CIV-01-445-F (W.D. Okla. Sept. 5, 2002), available at <http://www.ftc.gov/os/2002/09/okamicus.pdf>.

more of the frauds covered in the survey, and that an estimated 48.7 million incidents of these frauds had occurred during the previous year.<sup>3</sup>

The victims of fraud are as varied as the form of the fraud. For example, the AARP has shown that investment fraud victims are more likely to be male, 55–61, more financially literate, college-educated, higher income, and more optimistic.<sup>4</sup> Lottery fraud victims are more likely to be female, over 70 years old, less financially literate, less educated, and have lower incomes.<sup>5</sup>

Because fraud is often national in scope, and scarce Federal criminal law enforcement resources are primarily used against such matters as drug trafficking and terrorism, fraud will go largely unchecked without the active leadership of the Nation's consumer protection agency. We created the FTC's modern anti-fraud program in 1981 when I was Director of the Bureau of Consumer Protection. The development of a vibrant anti-fraud program at the FTC is a major success story. Fortunately, the legal tools for such a program already existed; in 1973, Congress had amended the FTC Act to allow the Commission to sue in Federal district court and obtain strong preliminary and permanent injunctive relief—including redress.<sup>6</sup>

We began by targeting the fraudulent sale of various types of unconventional investments.<sup>7</sup> The double-digit inflation of the period that made traditional investments relatively unattractive propelled these “alternative investment” scams. The first case involved defendants that fraudulently sold \$300 million worth of diamonds for investment.<sup>8</sup> Similar actions against boiler rooms selling advisory services for the Federal oil and gas lease lottery followed as did actions against the sellers of worthless oil and gas leases themselves. In this initial period the Commission brought three cases against sellers of gemstones and five cases involving oil and gas.<sup>9</sup>

Before the shift to Federal court, most of the Commission's consumer protection work used its administrative process. Most investigations relied upon voluntary production of requested documents and information from the investigated targets, who had every incentive to delay. This process had obvious drawbacks for addressing fraud. Federal district court cases proved much more effective, enabling the Commission to bring fraudulent schemes to an immediate halt, to take the targets by surprise so that money might be available for redress, and to prevent destruction of records showing the extent of the fraud and identifying injured parties.

Almost from the inception of the § 13(b) program, the Commission has used this tool not only to obtain court orders halting fraudulent schemes, but also to obtain consumer redress and other potent equitable remedies. Very early in the § 13(b) consumer protection cases, the Commission began to seek, as ancillary to issuance of permanent injunctions, provisional remedies such as a freeze of assets, expedited discovery, an accounting, and the appointment of a receiver on the ground that these remedies would insure the effectiveness of any final injunction ordered.<sup>10</sup>

<sup>3</sup> *Consumer Fraud in the United States: The Second FTC Survey*, FTC Staff Report, at s–1 (Oct. 2007), available at <http://www.ftc.gov/opa/2007/10/fraud.shtm>.

<sup>4</sup> FTC Fraud Forum, Presentation, Day One: Panel 1 (Doug Shadel, State Director, AARP Washington, *Advances in Fraud Prevention Research*), at slide 31 (Feb. 25, 2009), available at <http://www.ftc.gov/bcp/workshops/fraudforum/index.shtm#presentations>.

<sup>5</sup> *Id.* at slide 32.

<sup>6</sup> The Commission uses the “second proviso” of § 13(b), “in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction.” Trans-Alaska Pipeline Authorization Act, Pub. L. No. 93–153, § 408(f), 87 Stat. 576 (1973).

<sup>7</sup> See, e.g., John Villafranco, *Looking Back on the Muris Years in Consumer Protection: An Interview with Timothy J. Muris*, ANTITRUST, Summer 2004 80, 82–83. From the beginning of the § 13(b) program, the Commission has used this tool against a wide variety of scams, including real estate equity schemes, *FTC v. Rita A. Walker & Assoc.*, No. 83–2462 (D.D.C. filed Oct. 5, 1983); business opportunity scams, *FTC v. H. N. Singer Inc.*, 668 F.2d 1108 (9th Cir. 1982), *FTC v. Kitco, Inc.*, No. 83–467 (D. Minn. filed Apr. 9, 1983); and travel scams, *FTC v. Paradise Palms Vacation Club*, No. 81–116 (W.D. Wash. filed Sept. 25, 1981).

<sup>8</sup> *FTC v. International Diamond Corp.*, 1983–2 Trade Cas. (CCH) 65,725 (N.D. Cal.1983). The Commission previously had pursued administrative cases against unconventional investments. *American Diamond Corp.*, 100 F.T.C. 461 (Sept. 28, 1982) (complaint and consent order).

<sup>9</sup> In these initial consumer protection § 13(b) cases, Commission staff began the practice, still followed today, of working closely with other government agencies, such as the Department of the Interior's Bureau of Land Management, and Federal criminal enforcement authorities such as the United States Postal Inspection Service and the Secret Service in developing investigations and litigating cases. Parallel investigation and prosecution by both the FTC and criminal authorities have remained an important aspect of the Commission's § 13(b) program.

<sup>10</sup> *FTC v. H.N. Singer, Inc.* 668 F.2d 1108 (9th Cir. 1982) is a seminal case establishing the Commission's authority to seek, and the district courts' power to grant, all the traditional equitable remedies inherent in the authority granted by § 13(b) to obtain permanent injunctions. *Singer* was the first § 13(b) case to attack a business opportunity scam.

To make the best use of this approach, the Agency used modern investigative techniques geared for speed and stealth. The agency also developed a group of professional investigators trained to uncover fraudulent schemes, determine ownership and control of such schemes, trace assets, develop evidence, preserve evidence for trial, and testify in court. More recently, Commission investigators have become experts in Internet investigative techniques and have provided training for thousands of local, state, Federal, and international criminal and civil law enforcement offices.

Once launched, the fraud program grew in importance and success. Each succeeding FTC Chairman has expanded its scope and improved its operation. During the 1990s in particular, the agency formed strong, working relationships with state and local law enforcement agencies, leading sweeps against targeted types of fraud, thereby greatly increasing the program's effectiveness. By 2004, when my tenure as Chairman ended, there had been a total of 78 sweeps, resulting in 2,200 law enforcement actions.<sup>11</sup>

During the late 1990s, the fraud program matured under the strong leadership of Chairman Robert Pitofsky and Bureau Director Jodie Bernstein into the flagship of the Commission's consumer protection program. From Fiscal Year 1983 until Fiscal Year 1995—the first full 13 years that the Commission filed § 13(b) actions—the average number brought was 23 per fiscal year. During the Pitofsky-Bernstein years, that average skyrocketed to 71 filings per fiscal year. Not surprisingly, as the number of filings increased, so has the amount of consumer redress awarded. In Fiscal Year 2003, for example, nearly \$873 million in consumer redress was ordered in 98 judgments.

The Commission's ability to protect consumers from these scams was aided immeasurably by another Pitofsky-Bernstein innovation, the creation of the Consumer Response Center (CRC)—a central facility with trained call center staff and an automated call distribution system to record and respond to consumer complaints and inquiries. The existing telemarketing fraud complaint database, in operation since the early 1990s, was dramatically upgraded and revamped into Consumer Sentinel, a system linking law enforcers through a secure Internet site. The Consumer Sentinel system enabled the CRC staff to enter data from consumer complaint calls in real time. Initially scores, and ultimately hundreds, of law enforcement agencies at the state, Federal, and local levels joined the system, gaining access to the complaint database, as well as the opportunity to "cross-walk" their own complaint data into the Consumer Sentinel database. Other entities, such as local Better Business Bureaus, also were invited to contribute complaint data to the Sentinel database. Consumer Sentinel strengthened the fraud program by improving the staff's ability to spot emerging trends, to identify bad actors more quickly, and to locate potential witnesses to support the Commission's cases.

The Commission also has taken important steps to improve its cooperation with criminal law enforcement agencies. While I was Chairman, we established a Criminal Liaison Unit to coordinate with criminal law enforcement agencies across the country to encourage criminal prosecution of consumer fraud. The unit identifies criminal law enforcement agencies that may bring specific types of consumer fraud cases, educates criminal law enforcers in areas of FTC expertise, coordinates training with criminal authorities to help the FTC prepare cases for referral and parallel prosecutions, and provides Special Assistant United States Attorneys to help prosecute the worst FTC Act violators. Between October 1, 2002, and July 31, 2007, 214 individuals were indicted in telemarketing fraud cases resulting from referrals from the Criminal Liaison Unit.<sup>12</sup>

I also am especially proud of the expansion of the FTC's consumer protection efforts to the Spanish language media. Having grown up in Southern California, and having lived in southern Florida and Chicago, I was aware of the large and thriving Spanish language media throughout the United States. Yet, when I arrived in 2001, the FTC directed very little attention to marketing that appeared in any language other than English. We corrected that problem, hiring numerous attorneys and other staff fluent in Spanish, translating the FTC's excellent consumer education materials into that language, and bringing numerous cases against fraud and other illegal marketing practices that targeted the Hispanic community. That effort has continued. For example, in September 2006, the FTC co-hosted an Hispanic outreach workshop with the U.S. Postal Inspection Service (USPIS), the U.S. Attorney's Office for the Southern District of New York, and the Manhattan Hispanic Chamber of Commerce. During the workshop, the FTC announced three law enforcement ac-

<sup>11</sup> David R. Spiegel, "Chasing the Chameleons: History and Development of the FTC's 13(b) Fraud Program," 18 *Antitrust* 43 (2004).

<sup>12</sup> Prepared Statement of The Federal Trade Commission Before the Senate Committee on Commerce, Science, and Transportation, U.S. Senate, July 31, 2007.

tions against scammers targeting Hispanics with their unlawful business practices, as well as the results of a Hispanic Multi-Media Surf conducted by the FTC and 60 partners in the United States and Latin America.

The FTC's vital role as an antifraud agency continues today. Earlier this month, for example, it announced the results of a law enforcement sweep called "Operation Short Change," which included 15 FTC cases and 44 law enforcement actions by the Department of Justice, and actions by at least 13 states and the District of Columbia. The Operation targeted scammers seeking to take advantage of the economic downturn through a variety of schemes from phony debt-reduction services to promises of nonexistent jobs. In February 2009, the Commission held a two-day Fraud Forum with representatives from law enforcement, consumer advocates, business representatives, academics, and others exploring the problem of fraud and how the FTC can more effectively protect consumers from fraudulent schemes.

### III. The FTC and Rulemaking

As this Committee evaluates policy initiatives aimed at giving the Commission adequate tools to attack fraud, I would like to comment specifically on proposals to expand the Commission's rulemaking authority.<sup>13</sup> I submit that such proposals should be evaluated carefully and considered in the historic context of the Commission's purpose and mission.

#### A. The Role of FTC Rulemaking

As I discussed above, the agency has relied on the development of common law principles, supplemented with occasional rules and guides. The cornerstone of the FTC's consumer protection mission is the fraud program, through which the Commission has returned hundreds of millions of dollars to defrauded consumers.

Although many do not think of them as such, these common law principles *are* rules, providing a crucial part of the institutional framework that helps our market economy to function. In most circumstances, these common law rules provide both clear guidance to the business community and an adequate basis for FTC enforcement actions. Although common law rules do not provide civil penalties, there is no need for the civil penalties to combat fraud. The effective limit on the FTC's ability to recover money in cases of fraud is the money available, not any lack of authority to recover the funds.

The common law process is well suited to develop new policy. For example, the Commission has used this process to formulate general rules to protect the security of sensitive consumer information. Using both its deception and unfairness authority, the Commission has brought cases addressing information security, as the growth of the Internet and technology have created new vulnerabilities. Attempting to write a rule defining the scope of liability in advance could have stymied the natural development of this common law process, leading to uncertain results.<sup>14</sup>

Rules seeking to address fraudulent or other practices often are very difficult to write. Unlike the FCC, SEC, or other regulatory bodies, the FTC is not a sector-specific regulator. Thus, the agency generally lacks industry-specific knowledge, expertise, and routine contacts with regulated entities and Congressional committees with jurisdiction over those industries.<sup>15</sup> Instead, in its law enforcement experience, the Commission deals with pathology. It is familiar with bad actors, who have demonstrated their unwillingness to comply with basic legal principles.

By their nature, however, rules also must apply to legitimate actors, who actually deliver the goods and services they promise. Remedies and approaches that are entirely appropriate for bad actors can be extremely burdensome when applied to legitimate businesses, and there is usually no easy or straightforward way to limit a rule to fraudulent activities. Rather than enhancing consumer welfare, overly burdensome rules can harm the very market processes that serve consumers' interests.

<sup>13</sup> While my testimony today does not address proposals to codify third-party liability for FTC Act violations, potential problems could arise depending on the precise legislative language.

<sup>14</sup> Although the FTC promulgated the Safeguards Rule at the same time as it was initiating information security cases, the rule was primarily useful in establishing a structure for remedies. Adopted under GLB, the rule set out a flexible, process-oriented approach to providing information security. Because Congress had specified liability for financial institutions that failed to protect sensitive information, the rule did not require a theory of who was liable under Section 5 and under what circumstances. Those theories were developed through the common law process in individual cases, and most of the Commission cases have involved industries not within GLB's jurisdiction.

<sup>15</sup> Of course, the agency and its staff have become quite knowledgeable about certain sectors of the American economy, including, for example, the downstream parts of the oil industry, certain aspects of health care, and credit reporting agencies. For credit reporting agencies, the FTC is the regulator, and pursuant to the FACT Act, has promulgated numerous rules in the last few years. These rules, and many others, were promulgated pursuant to Congressional direction.



For example, the Commission's initial proposal for the Telemarketing Sales Rule was extremely broad and burdensome, and one of the first acts of the Pitofsky Commission was to develop a narrower approach to the rule. More recently, the Commission found it necessary to repropose its Business Opportunity Rule, because the initial proposal would have adversely affected millions of self-employed workers.

Of course, rulemaking can be appropriate. For example, the Commission sometimes can provide "rules of the game" that reduce consumer harm in the future. The Commission can establish new default rules and procedures for transference of rights when it is otherwise difficult to do so. Thus, the Commission's Mail Order rule provides that unless the parties agree otherwise, the merchandise must be delivered with 30 days. While seeking to facilitate the exercise of consumer choice, the agency is also highly cognizant of the need to avoid unduly shackling market forces.<sup>16</sup> For example, this balance undergirds the FTC's approach to unsolicited telemarketing calls, through which consumers decide whether or not they wish to receive such calls and express their preferences effectively through the Do Not Call registry. Once these new rules of exchange are established, if transaction costs are low, parties can more easily transfer these rights.<sup>17</sup>

It would be a major mistake for rulemaking to be a substantial component of FTC consumer protection. The FTC went down this road once before, with disastrous consequences. In the 1970s, using its unfairness authority under Section 5 without meaningful standards, the Commission embarked on a vast enterprise to transform entire industries. Over a 15-month period, the Commission issued a rule a month, usually without a clear theory of why there was a law violation, with only a tenuous connection between the perceived problem and the recommended remedy, and, at best, a shaky empirical foundation.<sup>18</sup> The enterprise foundered because of the internal inadequacies of the Commission's procedures and because of intense Congressional opposition.

As it did before, the FTC will fail in its mission to protect consumers if it seeks to become the second most powerful legislature in Washington. This is surely an unsuitable task for five unelected representatives, not closely supervised by the White House or a Cabinet department.

Regardless of the procedures, rulemaking is a resource-intensive activity that inevitably draws resources away from enforcement. While I was Chairman, the agency was pursuing subprime lending cases involving failure to disclose adequately key terms of the transaction. In 2005, however, as more and more dubious loans were made, the agency diverted substantial resources to rulemakings to implement the FACT Act. The FTC asked for rulemaking authority in one narrow area (risk-based pricing); it ended up with statutory mandates for more than a dozen separate rules and studies. Whatever their value, those rules and studies consumed resources the Commission could have productively employed on cases.

#### *B. Magnuson-Moss Procedures Are Appropriately Tough, But Usable*<sup>19</sup>

Rulemaking is an exercise in generalization. The FTC should determine whether a problem occurs often enough to justify a rule, whether the problem has a common cause in a sufficient number of cases to justify the remedy, and whether that remedy can correct the problem without imposing excessive costs. Because the FTC cannot generalize simply from its own experiences or from the horror stories of others, it should rely on projectable evidence such as surveys of consumers and econometric studies of industry behavior.

<sup>16</sup>See, e.g., Comment of the Staff of the FTC before the Department of Health and Human Services Food and Drug Administration, In the Matter of Food Labeling: Health Claims; Dietary Guidance, Docket No. 2003-0496 (Jan. 2004), available at <http://www.ftc.gov/os/2004/040126fdacomment.pdf>.

<sup>17</sup>See R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 15-16 (1960) ("Once the costs of carrying out market transactions are taken into account it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about.")

<sup>18</sup>For similar criticisms of the FTC's rulemaking binge, see the extensive, contemporaneous studies by Barry Boyer (Report to the Administrative Conference of the U.S., Trade Regulation Rulemaking Procedures of the Federal Trade Commission, 1979) and Teresa Schwartz (*Regulating Unfair Practices Under the FTC Act: The Need for a Legal Standard*, 11 Akron L. Rev. 1 (1977)). See also Muris, *Rules Without Reason—The Case of the FTC*, 6 Regulation 20 (Sept./Oct. 1982).

<sup>19</sup>Although within the Commission these procedures are uniformly referred to as "Magnuson-Moss," in fact, the procedures are contained within Title II of the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act of 1975. Only Title I involved the Magnuson-Moss Warranty Act, but I use here the conventional designation of Magnuson-Moss procedures.

The Magnuson-Moss procedures force the Commission to be clear about its theories and focus its evidence on the key questions. Otherwise, the procedures can make the rulemaking almost interminable. The ability of rulemaking participants to designate disputed factual issues and cross examine witnesses on those issues is very useful in testing the Commission's theories. Properly focused, Magnuson-Moss procedures are workable.

The Commission's recent experience in the Business Opportunity Rulemaking is a reminder of the useful aspects of the Magnuson-Moss procedures. The Commission proposed a wide-ranging rule, apparently aimed at fraud, but that instead would have adversely affected millions of self-employed workers and the consumers they serve. Based on the public comments and the need to proceed under Magnuson-Moss, the Commission has now sensibly proposed a much more targeted rule that addresses fraud without regulating legitimate businesses. Although the Commission may have retreated without the threat of hearings and cross examination, those threats undoubtedly helped to influence the Commission's deliberations.

The FTC has successfully used Magnuson-Moss Rulemaking in the past. Several of the rules proposed in the 1970s were eventually promulgated. Some rules, like the two involving eyeglasses, were well conceived initially and concluded expeditiously. More recently, the Commission has used these procedures to amend the Franchise Rule, and is well on its way to concluding the Business Opportunity Rule successfully.

The Commission's most prominent rulemaking endeavor, the creation of the National Do Not Call Registry, could have proceeded in a timely fashion under Magnuson-Moss procedures. It took 2 years from the time the rule was first publicly discussed until it was implemented. Although it would have been necessary to structure the proceedings differently, there would have been little, if any, additional delay from using Magnuson-Moss.

#### *C. Magnuson-Moss Procedures Should Be Retained*<sup>20</sup>

The problems that resulted from FTC rulemaking in the 1970s are not just that the agency needed "better" regulators. Instead, the problem is one of incentives and constraints. We are in a period of unusual government activism. Numerous groups will press the Commission for immediate action, whether or not the proposal is well thought out. In the short run, Congress may push hard for action as well. Without the constraints of the Magnuson-Moss procedures, the potential for mischief and long run harm to the Commission and to consumers is enormous. Although Congress and the courts eventually may restrain the Commission, it would be far better to avoid these costs from the beginning.

It is true that part of the problem from the 1970s has been addressed with the Commission's adoption of the Deception Policy Statement and the codification of the definition of unfairness. Nonetheless, the Commission's authority remains extremely broad. The procedural safeguards of Magnuson-Moss create a strong need for the Commission to develop clear theories and strong incentives to develop a firm evidentiary base early in the rulemaking proceeding. When these requirements are met, Magnuson-Moss rulemaking is workable.

In a number of areas, the FTC has engaged in rulemaking, pursuant to Congressional direction, using APA procedures. Congressional directives avoid a significant part of the problems that bedeviled the FTC in the 1970s, as they provide explicit political "cover" for the specific rulemaking at issue. That cover may subside, however, as the political tides shift or as the specific parameters of the proposal prompt fierce industry resistance. Moreover, Congressional directives often remove the question of what constitutes a violation, which proved to be one of the most contentious issues of many 1970s rulemaking. Even with congressional authorization, I would retain Magnuson-Moss procedures when a rulemaking is major and when Congress has not specifically defined the violation.

#### **IV. Safeguards Should Accompany Any Expansion of State Enforcement Authority**

As discussed above, the State Attorneys General have been important partners of the FTC in fighting fraud. From personal experience, I can attest to the diligence

<sup>20</sup>The Administration's proposal would do more than just change the procedures used in rulemaking. It also would eliminate the requirement that unfair or deceptive practices must be prevalent, and eliminate the requirement for the Commission's Statement of Basis and Purpose to address the economic effect of the rule. It also changes the standard for judicial review, eliminating the court's ability to strike down rules that are not supported by substantial evidence in the rulemaking record taken as a whole. The current restrictions on Commissioners' meeting with outside parties and the prohibition on *ex parte* communications with Commissioners also are eliminated. These sensible and important protections should be retained.

and professionalism of those with whom we worked in Attorneys General offices across the United States. Nevertheless, it is important to recognize recent problems that have arisen in a few states involving the outsourcing of enforcement responsibilities.

Some in Congress want to grant greater authority to State Attorneys General to enforce Federal law. If you choose to extend such authority to the states, I respectfully urge the Committee to consider adding safeguards to ensure that such authority is exercised in a uniform, transparent, and impartial manner.

In recent years, Congress has enacted several statutes that expand the authority of state and local governments to enforce Federal laws into new areas. For example, State Attorneys General are now empowered to enforce Federal laws governing diverse issues such as telemarketing, online gaming, and transportation of household goods—to name a few. Indeed, in the past few months alone, Congress authorized State Attorneys General to enforce the Federal Health Insurance Portability and Accountability Act, the Federal Truth in Lending Act, and any mortgage loan rules promulgated by the FTC.

Delegating Federal enforcement power to state actors gives rise to two important and related problems. First, Federal regulatory regimes are at a significant risk of being enforced in an inconsistent and unfair manner. Numerous safeguards ensure that Federal prosecutorial efforts are consistent, fair, and free from outside bias or interference. Those safeguards include statutes prohibiting bribery, ethics rules governing political activities of anyone retained by the government to assist in enforcement efforts, and Executive Order 13433, which limits the use of contingent fee arrangements with private attorneys retained by the government. By contrast, states are generally not subject to such safeguards. As a result, granting Federal enforcement authority to the states can result in haphazard prosecution efforts and opportunities for public corruption.

Second, state enforcement is likely to result in an increase in contingency-fee contracts between states and private attorneys. Contingency fee agreements by their nature often operate to the detriment of the general public. In the public litigation context, contingency fee arrangements create significant conflicts of interest. A basic principle of good government is that public actors should not participate in decisions in which they have a financial stake. Deputizing plaintiffs' attorneys with contingent fee contracts to serve as private attorneys general flouts this fundamental principle, because those attorneys get paid nothing unless they win—and they have no chance of winning unless they decide to prosecute claims. Accordingly, such attorneys have a clear incentive to litigate (and to continue litigating) even when doing so is not in the public interest.

For all of these reasons, Congress should approach the expansion of state authority to enforce Federal laws with care—and ensure that any such expansion is accompanied by some or all of the following sensible safeguards to ensure that Federal laws are enforced in an open, impartial, and ethical manner:

- *Require Disclosure of Private Attorney Retention Agreements.* State officials who retain private attorneys to enforce Federal law should be required to disclose the arrangement to the Federal Government for publication in the Federal Register. Requiring transparency will improve Federal oversight of state enforcement efforts, which will help ensure the objective, consistent implementation of Federal laws.
- *Prohibit “Pay-to-Play” Arrangements.* Congress should sever the connection between campaign contributions and “private attorney general” retentions by prohibiting state and local government officials from rewarding substantial campaign contributors with potentially lucrative contracts to enforce Federal laws.
- *Prohibit Contingent Fee Arrangements Absent Necessity.* Under Executive Order 13433, Federal agencies using private attorneys to assist in the enforcement of Federal law may use contingent fee arrangements only where it is cost effective and consistent with the public interest. Congress should apply these same standards to state and local governments' efforts to enforce Federal law.

Although these safeguards would promote transparency and reduce ethical concerns about the use of contingent arrangements to reward political donors, they would not diminish the capacity of state and local governments to make independent, objective judgments about the best course of action in each case involving enforcement of Federal law. In short, if Congress wishes to delegate Federal enforcement authority to non-federal actors, these safeguards increase the likelihood of obtaining any benefits from such delegation without incurring adverse consequences.

## V. Conclusion

Once again, thank you for the opportunity to testify today. I would be glad to answer any questions.

Senator PRYOR. Thank you.

Again, I want to thank the panel for all of their testimony today, and your hard work, and the fact that you're here right now.

Mr. Vladeck, let me start with you, and let me ask about Operation Short Change. I think you covered some of this in your opening statement, but tell the Subcommittee here what prompted you all to do Operation Short Change. I know it's still fairly new, but please give your sense of how it's working so far.

Mr. VLADECK. Let me start by explaining the genesis of these kinds of sweeps. We want to target our enforcement efforts, particularly these kinds of economic-downturn-related enforcement cases, to those who are the most vulnerable. And Operation Short Change focused on those kinds of frauds that tend to affect the most vulnerable among us—the poor, the elderly, those deeply in debt. And so, we focused on five areas: phony income-generating opportunities; job placement scams, the one that entrapped Beverly Stewart; government grant scams, the stimulus package grants that General Koster talked about in his opening statement; credit-related scams; and mortgage loan-modification scams.

This was a coordinated effort with our partners in the states and with the Department of Justice. And so, our aim was to try to send a signal, as loudly and as clearly as we could, that we intend to target these kinds of scams, going forward, and, in part, to generate some publicity, because I think, as Sally Greenberg mentioned, consumer education is a vital part of our enforcement effort. We need to get the word out to the American people that these scam artists are trying to pick their pocket. And so, that was the genesis of the sweep, and that's why it had the focus that it did.

Senator PRYOR. And again, I know it's fairly early in the process, but, so far—as I understand it, there has been several TROs and things like that going on around the country. Can you give us just a quick status? I know it's still a fairly new—

Mr. VLADECK. In most of the cases in which a defendant has appeared, we've obtained preliminary injunctive relief; that is, we've gotten a TRO preventing the scam from moving forward. In many of the cases, as well, we've gotten an asset freeze. So, we've grabbed whatever money there is. Hopefully, at some point we'll be able to use that money to return the money that's been taken from consumers to the consumers. And consumer redress, getting money back to consumers who have been scammed, is an integral part of our enforcement efforts. I don't have the statistics at ready, but I think that, of the 15 cases that we brought, we've gotten preliminary relief in virtually all of them.

Senator PRYOR. And I know that when you take on an effort like this, you have to coordinate with DOJ, and they have an important piece of this, as well as the states—they have an important piece of it. From your experience, how is that coordination going between various Federal and State agencies?

Mr. VLADECK. I would say that it is going well, but we need to do better. Our job is sort of a biblical one. We need to take the resources we have and multiply them. And the way to do that is

through strategic partnerships, both within the Federal establishment, strengthening our ties to the Department of Justice, with other agencies that have an enforcement role—the Postal Service, the Food and Drug Administration, on some of these health scams, and with HHS, their Office of Aging. So, we need to strengthen those partnerships. We need to strengthen our partnerships with the State Attorney Generals. We're delighted that we were able to work with the Missouri AG's office in Operation Short Change. The sweep that will be announced tomorrow will reflect very close ties with the California AG's office and with county offices within California, and other states. And we need to do a better job reaching out to the legal services providers, who are often on the front lines of this. They are part of the team, here, in terms of combating fraud. We do not have, at the moment, adequate ties to legal services providers, and we will be reaching out to them.

And then, there are local law enforcement agencies around the country, county attorneys offices and so forth, that are involved in consumer protection efforts. We need to reach them, as well. We now distribute our materials, our publications, to over 10,000 organizations, from State Attorney Generals to counties to extension service programs. We need to do more.

Senator PRYOR. Thank you.

Senator WICKER, if you'd like to make an opening statement, that would be great with the Subcommittee, or if you—

**STATEMENT OF ROGER F. WICKER,  
U.S. SENATOR FROM MISSISSIPPI**

Senator WICKER. Thank you.

Senator PRYOR.—have any questions.

Senator WICKER. Thank you, Mr. Chairman.

I think I will ask unanimous consent to enter my opening statement in the record.

Senator PRYOR. Without objection.

Senator WICKER. OK. And I appreciate that. I know we're trying to carry on several conversations at one time.

[The prepared statement of Senator Wicker follows:]

PREPARED STATEMENT OF HON. ROGER F. WICKER, U.S. SENATOR FROM MISSISSIPPI

Mr. Chairman, I want to thank you for holding this hearing today.

With the downturn in the economy and rise in unemployment rates, everyone is feeling the effects of our economic crisis. Americans are working to pay down their debt and clean up their finances. Unfortunately, some are trying to take advantage of those most in need. Scammers are using the economic downturn to prey upon those who have been most affected.

If someone is unemployed, scams offering "get rich quick" plans appear very inviting. For only a small investment in a work-at-home kit you can make over \$5,000 a month from the comfort of your own home.

The opportunity to receive a Federal grant for personal use to pay off debt or renovate your house sounds appealing even during the best of economic times. For a small fee you can receive access to available Federal grants and receive free money.

A phone call alerting you to the process for redeeming your sweepstakes winnings can also sound enticing. If you just pay the taxes due on the winnings, you can have the prize monies deposited directly into your bank account.

Eventually the people who fall for scams like the Federal grant scams, the "get rich quick" schemes, or employment scams don't realize they've been taken advantage of until it's too late. The small fees pile up and the victim is left in further debt with their personal financial information compromised.

Scammers have even used recent public events or government action to take advantage of Americans. Opportunities to receive your “Cash for Clunkers” rebate over the Internet or to receive your personal cut of the economic stimulus program appeared online very quickly, even before the programs became law. Consumers are duped into believing these online offers are legitimate government programs.

The Federal Trade Commission is actively working to catch these criminals. The Commission, working with other Federal and state law enforcement agencies, regularly conducts large sweeps targeting these scams and other fraudulent activities. I look forward to Mr. Vladeck’s testimony and hope he discusses these efforts in more detail.

Public education relating to these scams and other fraudulent activities is a good tool to combat these threats. While the Commission’s actions after the scam has occurred are necessary, the American public would be well served by being better educated to recognize these scams upon solicitation. I hope our witnesses today will discuss how we can help increase the public’s education on these frauds.

I also appreciate former Commission Chairman Tim Muris for joining us today. While the specifics of the scams we will hear about today are new and relate to current events, such as the stimulus or the housing market, the way these scams are carried out is not new. His testimony will help us get a broader understanding of how the Commission has successfully combated these scams in the past. I also look forward to hearing his views regarding the Commission’s ability to fight these fraudulent activities.

Thank you again, Mr. Chairman, for holding this hearing.

Senator WICKER. I appreciate the Chair’s indulgence. And I want to say, I also appreciate punctuality, and I didn’t observe that virtue today.

Let me start with Mr. Vladeck, and then perhaps others will join in.

Clearly, there has been an effort at education, at consumer awareness programs. We certainly had our share of scams in Mississippi, following Hurricane Katrina. When these crises or unfortunate circumstances arise, there are always people there, as Mr. Muris says, to steal from. Fraud is stealing. Chinese drywall is a problem that this Congress is looking into. We need to increase consumers’ awareness of these scams. We need to jump on it as quickly as possible, at the onset of a scam, so that individuals—vulnerable individuals can get the message.

I know the FTC and consumer groups are working to get messages out, but how do we review education programs to see which ones are working? I mean, something might look good to me on television, and it might make sense to someone who looks at this issue every day, but how do we determine best practices for effectively educating consumers? And how do we measure effective education?

I’ll start with you, Mr. Vladeck.

Mr. VLADECK. Well, that’s a great question, and one that we spend a lot of time thinking about.

With respect to the Internet, our Internet education efforts, we can track pretty well the people who use them, at least in terms of the sheer numbers. But, with respect to the other kinds of information that we disseminate—printed material and so forth—the only measure that we really have is the demand for them. That is, when I talk to other State Attorney Generals—for example, Attorney General Roy Cooper, from North Carolina, was up for Operation Short Change—the first thing he said to me was, “Keep on sending us these educational materials,” because in every regional office of the State, they distribute them. So, one way to do it is just

to take a look and get the feedback from the constituents that we provide these materials to, and get feedback from them.

The feedback we get is quite good, but I'm not sure how a newspaper would go about trying to figure out, not simply how many people get reached, but how many people actually read the stories and actually took away the right message.

Senator WICKER. I do believe they do that.

Mr. VLADECK. We are looking at ways of measuring that kind of impact. Of course, unlike a newspaper, our materials are distributed to every State, through every extension service, through county attorneys offices, through police departments, and through universities. The distribution is quite wide. And I'm not sure that we have the capacity, really, to answer your question in the concrete way that I think that you want it.

Senator WICKER. Ms. Greenberg, you might want to be next on this. I believe you hinted at an alliance of groups and industries to create uniform messages for consumers. So, would you expand on that? And do you have some suggestions for this panel today on determining best practices and making sure that our education efforts actually penetrate?

Ms. GREENBERG. Well, one recent example is an effort that was undertaken by the U.S. Postal Inspection Service to deal with a fake-check scam. This was in October of 2007. USPIS launched \$12 million, I believe was the figure, outreach campaign that involved a very sophisticated series of advertisements. And it really penetrated the airwaves. I think they found it was quite successful and colleagues of ours and people that we work with at American Express said that they saw the number of fake-check problems and complaints go down significantly during the course of this campaign. And it was advertisements—it was, like, you take a Vitale guy, and you have an actor play this guy, and they were doing role playing. So, he would go in, sit down at a—let's say, on a bus, and say, "Hey, would you like to write me a check for \$50,000?" The person says, "Of course not." So, it's that sort of thing. And then he says, "Well, why would you do it in any other context?" And it was very focused. I'm sure the FTC was involved in the fake-check campaign, as were a number of other Federal agencies.

So, what we're talking about is money, a sophisticated media outreach using Web 2.0 efforts, new media efforts, you know, all the Facebook and Twitter tools that we have. It takes money, and it takes a really focused effort. But, I think the kind of work that David Vladeck is doing at the FTC really makes a big difference.

I saw an FTC person on CNN. That gets out—she's in the room—a lawyer. And she was talking about, "Don't fall for it." I mean, these kinds of outreach efforts are really, really effective, but if we put the money there, I think that we can make a dent.

Senator WICKER. Mr. Vladeck, was the FTC involved with the Postal Service in that specific incident?

Mr. VLADECK. I'm not certain, but I'll get back to you on that.

Senator WICKER. Thank you.

Mr. VLADECK. Thank you.

Senator PRYOR. Thank you.

And next we have, Senator Bill Nelson. And Bill has a very important Finance Committee hearing to get to, and to demonstrate

his commitment to consumer protection, he stayed in order to ask questions.

Thank you for being here.

**STATEMENT OF HON. BILL NELSON,  
U.S. SENATOR FROM FLORIDA**

Senator NELSON. Thank you, Mr. Chairman.

The purpose of this hearing is to see if the U.S. Government is protecting the consumer in these down times. The FTC labors under a very cumbersome rulemaking process so that you attack a lot of the problem after the scam has occurred.

So, Mr. Vladeck, what are we going to do to get these rules in place so that everybody knows, if you cross that line, immediately you jump on them?

Mr. VLADECK. Well, since 1947, the standard way Federal agencies make rules is under the Administrative Procedure Act. It sets forth a notice-and-comment system, it provides the public an opportunity to weigh in, and provides for judicial review at the end of the process. The FTC, by and large, may not use that ordinary mainstream rulemaking process to issue its rules; we are saddled with a very cumbersome rulemaking process—

Senator NELSON. So, are you saying that you can't adopt bright-line rules that, when they cross that threshold, you can jump them?

Mr. VLADECK. We can adopt those rules, 5 or 6 years down the road. We cannot use that rulemaking process, in a situation like this, to respond quickly to emerging problems in the economy.

Senator NELSON. So, is the FTC impotent to attack these scams?

Mr. VLADECK. No male is ever going to use that word, Senator. [Laughter.]

Mr. VLADECK. We are—

Senator NELSON. Well, I just did.

Mr. VLADECK.—we are hobbled, because, instead of using rulemaking, we have to proceed, case by case.

Senator NELSON. All right.

Mr. VLADECK. And so—

Senator NELSON. Well, obviously, it isn't working.

What do you think, Mr. Muris?

Mr. MURIS. I could not disagree more with the premise of Mr. Vladeck. These people are crooks. We already have rules against their behavior. And what we need is strong, aggressive enforcement.

In one year when I was Chairman, we got over \$900 million back for consumers. We've worked with criminal authorities, as the Commission does, to this day, and has put hundreds of people in jail.

Rules are distractions. Let me tell you what happened in the 1970s. The FTC tried to compete with you, and indeed, be a legislative body. That does not work. The FTC has five unelected officials. The rulemaking procedures that Mr. Vladeck discusses are procedures that were put in place by Congress because the FTC's jurisdiction is so broad. Rather than wasting their time writing rules, which would apply to legitimate, as well as illegitimate businesses,



in the fraud area, the Commission needs to do what it's doing, which is going after the bad actors. I believe it can do even more.

A final point is, when another committee and then the Congress passed reauthorization of the Fair Credit Reporting Act, we asked for one rule. The Congress gave us something like 15 or 16. The people who worked on those rules and studies got taken away from working on cases. I do believe the FTC needs the adequate resources, but you just can't go out and hire people. You need to train them, you need to work with them.

So, I believe the rulemaking effort is a distraction. You should retain the FTC's current rulemaking authority.

Senator NELSON. Well, Mr. Chairman, if—any other questions from me would be superfluous. I think we've seen there's an inability of the system to react to a circumstance to try to head it off in the first place.

Mr. VLADECK. May I respond briefly to Mr. Muris?

We are currently working on two rules, pursuant to APA procedures, because Congress authorized us to do this. These are the mortgage rescue, mortgage foreclosure rules.

We do not have parallel authority for debt. We are doing debt workshops, we are looking at debt issues. But, it would have been helpful to be able to jump on some of these issues more quickly with rulemaking authority.

Mr. Muris is right, in one sense. Rules take time, they can be distractions. You have to be strategic about the rules that you want to issue.

Everyone learned the lesson of the 1970s. I don't think this Commission wants to be a junior legislature. What we want to do is be able to protect consumers from emerging threats of the kind that we've seen over the last 2 years, and the rulemaking authority that we currently have does not permit us to do that. That is the view of the Commission.

Senator NELSON. Sounds like we've got a lot of work on this to do, Mr. Chairman, to protect consumers from scams.

Senator PRYOR. It does. And we'll—

Senator NELSON. Now, the Attorneys General certainly have that power. I had that power, as a regulator, as a State cabinet officer, before I came to the Senate. But, it doesn't seem like we've got the ability for an immediate response here.

Senator PRYOR. I think we'll have a robust discussion about that as we do our FTC reauthorization over the next several months. I know there's a difference of opinion and I appreciate everybody's input.

Thank you for being here, and I know you need to race out to your Finance Committee hearing.

Senator McCaskill? Thank you.

**STATEMENT OF HON. CLAIRE McCASKILL,  
U.S. SENATOR FROM MISSOURI**

Senator McCaskill. Thank you very much.

I want to, first, on a personal note, say how terrific it is to see the Attorney General from Missouri here. Chris and I have known each other a long time, and there are many chapters to our friendship that goes back to the time that I was the elected prosecutor

in Kansas City and he was the elected prosecutor in the county immediately south of Jackson County. And we worked together then, he is a very talented and is going to be a terrific Attorney General for the State of Missouri. I couldn't be happier to see him here today.

As you know, Mr. Chairman, and as Mr. Bell referenced, I've been trying to do a lot of work in the area of reverse mortgages. We have had a series of three hearings on reverse mortgages—one in Washington, two field hearings in Missouri. It is very clear to me that these are complicated, expensive financial instruments, that, while maybe appropriate, in limited circumstances for some seniors, with appropriate counseling and appropriate information, they are being marketed now in ways that make my blood boil. And one of the things we discovered in one of the hearings is that there are actually people out there that are on marketing lists, with titles like "Lonely Seniors," "They Will Talk to Anyone" lists—"People Who Play the Lottery," and "Easy Prey."

I'm curious, General Koster, in the investigations that you all have done and that you continue to do in this wide area of scams against consumers, and particularly the elderly, have you looked at ways that people are being targeted, in terms of what information is being gathered and how people are being selected to receive the mail solicitations, to receive the phony checks? Have you all had an opportunity to look at that part of it?

Mr. KOSTER. Candidly, a lot of the information that has come out in our state has been as a result of the work that you have done when you brought your committee and conducted hearings around the state. I was listening to the comments about, "How do we raise public awareness?" And I believe that the political community, in conjunction with the media, still does a great job of raising awareness.

So, I am aware of the targeting that is occurring, as though they were marketing different types of magazines to seniors. My experience is that nine out of ten of these reverse mortgages, and increasingly these sale-leaseback arrangements, which are nothing more than stealing the equity from senior citizens, largely, and then renting them their house at an elevated price, have been tremendous advantage-taking opportunities by scammers.

Senator MCCASKILL. I know, Mr. Vladeck, at the FTC, that you are looking into reverse mortgage advertising and marketing. And it's my understanding that there is a task force, headed by the FTC, with Treasury and HUD, that is looking into these advertising practices in this way. And—by the way, I got a Tweet yesterday from someone who said that there was a mailing in Illinois that had gone out from one of these institutions, marketing these reverse mortgages, saying that this was, in fact, a stimulus benefit, an American Recovery and Reinvestment Act benefit, similar to what you all have spoken about this morning; whether it's bailout or stimulus, those are the scam phrases of the day, but it doesn't matter what the economic climate is, they always manage to find a scam phrase.

Tell me, Mr. Vladeck, how is that task force going? And what, if any, action are you all taking as it relates to the advertising?

Mr. VLADECK. Well, as you know, we are in the midst of a rulemaking that will address the entire life cycle of the mortgage process, including the advertising. So, we're hoping to address, at least in part, that question through rulemaking. The rulemaking has already commenced. We're hoping to have this done as quickly as we can. We're also looking for cases like these equity-stripping scams, that General Koster described. So, if you have that Twitter, please forward it to me and we'll take a look at it—

Senator MCCASKILL. Well, in fact, I just put out a Twitter while I was sitting here listening to the testimony—

Mr. VLADECK. Please.

Senator MCCASKILL.—asking people who follow me to give me examples—other examples of scam advertising that they may encounter as it relates to these folks promising government benefits that—and, by the way, *Time* magazine had an article this week on—and I know I'm almost out of time, but I want to mention this for the record—*Time* magazine had an article about reverse mortgages this week, which was great, except they got one part wrong, and I want to point out the part they got wrong. If, in fact, these homes lose value, which obviously none of us thought would ever happen, and it has happened—and, of course, that is really one of the reasons we are in this incredible economic crisis right now—if these homes lose value, and, at the end of this process, when the home is finally sold, and it is not sufficient money there to pay the loan, it said in the article that the lenders got left holding the bag. I want to point out for the record that it's the taxpayers that get left holding the bag, because we are insuring 90 percent plus of these loans that are being made right now, and we just upped the limit of the amount that could be loaned, and these are increasing by huge margins, and this is, in fact, potentially the subprime scam—the subprime problem, 4, 5, 10 years from now, and it won't come due for a while, because we're not going to know that we're going to be caught in these loans until these homes are sold. So, I encourage all of you to continue to be vigilant in that particular area because these seniors really deserve more protection than they're getting right now.

And once again, thank you, General Koster, for being here today. We're—it's terrific you're here, and I hope you come back often to show off what a great job we do in Missouri, protecting people.

Thank you, Mr. Chairman.

Senator WICKER. Mr. Chairman, in order to have a complete record, here, I wonder if Senator McCaskill would join me in asking unanimous consent that that article be placed in the record at this point.

Senator MCCASKILL. Absolutely. Absolutely. And we will put in the response letter we're sending *Time* magazine that corrects that inaccuracy in the article—that it's the taxpayers that are on the hook for these loans and not the banks.

Senator PRYOR. No objection.

Senator MCCASKILL. Thank you.

[The information referred to follows:]

TIME Magazine, July 20, 2009

## REVERSE MORTGAGES

By Cybele Weisser

While the recession hasn't spared any age group, it's been particularly brutal for older Americans who were counting on their (now shrunken) nest eggs to last through their retirement years. To supplement their stash, an increasing number of seniors are turning to reverse mortgages, which function essentially as a cash advance on their home equity, repaid only when they sell their home or die. The loans are available to those 62 and over, and lenders have to eat the difference if a home ends up declining in value. In the three months after February—when a provision in the economic-stimulus package raised the eligible home-value limit from \$417,000 to \$625,500—the number of federally insured reverse-mortgage originations jumped 10 percent compared with the same period last year. Industry experts predict that reverse mortgages will play an increasingly important role in the coming years as some 70 million baby boomers hit their 60s—often with a lot less saved than they'd hoped.

This has some folks in Washington concerned. In June, the Government Accountability Office said it had uncovered misleading marketing practices in the reverse-mortgage industry, and Missouri Senator Claire McCaskill, a longtime consumer advocate, chaired a hearing to investigate predatory lending tactics. A big no-no is cross-selling, *e.g.*, trying to persuade a senior to get a reverse mortgage and use the funds to buy an annuity or other financial product.

Comptroller of the Currency John Dugan recently noted that reverse mortgages, like some flavors of the infamous subprime mortgages, are too complex for many seniors to understand. "Millions of older Americans still have a lot of equity in their homes, and it's tempting for them to tap into this pot of money," he says.

Still, under the right conditions, these loans can be a sensible solution to a tough financial situation. So if you or your parents are considering one, here's what you need to know:

The amount you can borrow is based on interest rates, your age and the value of your home. (Use the calculator at [rmaarp.com](http://rmaarp.com) for an estimate.) There are no credit or income requirements to get a reverse mortgage, but you must be able to keep up with property taxes and insurance bills—or you could lose your home. The upfront costs are high. Generally, \$10,000 to \$15,000 in fees are lopped off the amount you can borrow. Finally, if someone is pressuring you to take one of these loans in order to buy something else, that's a huge red flag. Walk away.

Lenders aren't allowed to close on a federally-insured reverse mortgage until borrowers meet with a HUD-approved counselor, who is required to help them explore alternatives such as selling their home or lowering their expenses. That's because the greatest reverse-mortgage risk, especially for younger borrowers, may be that they will live longer than they expected and drain all the available equity from their home. Says reverse-mortgage specialist Bronwyn Belling: "If you borrow the money now, you may not have it when you need it later on."

## LETTER TO TIME MAGAZINE

While I applaud Cybele Weisser's piece concerning reverse mortgages, I want to take issue with one conclusion stated in the article: "Lenders have to eat the difference if a home ends up declining in value" [July 20]. Wrong. Taxpayers make up the difference, not lenders. A little over a month ago, the Department of Housing and Urban Development (HUD) asked for \$800 million to cover losses on its reverse-mortgage program. That is because HUD insurance allows lenders to assign loans to HUD once the value of the home has dropped to nearly the value of the loan. So far, more than \$1 billion in loans has been passed on to HUD. With fluctuating home values and interest rates, it is difficult to know how much more money HUD will have to come up with. The more loans it insures, the greater the risk to taxpayers. Without greater oversight, that initial \$800 million will just be the start. While reverse mortgages can provide financial help to seniors, they are expensive and complicated, and ultimately, taxpayers will foot the bill if the loan goes bad. After the subprime mess, we cannot afford to let history repeat itself.

CLAIRE MCCASKILL,  
U.S. Senator, St. Louis, MO.

Senator PRYOR. Senator Klobuchar, welcome back.  
Senator KLOBUCHAR. Thank you very much, Mr. Chairman.

When I was out, my staff told me that you, Mr. Bell, haven't been asked a question yet, so I guess I have to——

[Laughter.]

Senator KLOBUCHAR.—I have to fix that, as well as you, Ms. Greenberg. So, there we go.

You know, in your testimony, Mr. Bell, I was struck by what I think is good common sense for financially troubled consumers facing foreclosure, and that is one of your commonsense ideas, something that Prentice Cox, from the University of Minnesota, has talked about. If someone asks for a fee up front for counseling, it's a probable signal that there may be a possible predator. Do you want to talk about that? And also, what other things we can do, and maybe launch a little into what you think of this idea of setting up a special agency to deal with financial documents and financial fraud.

Mr. Bell?

Mr. BELL. Thank you very much.

Well, I would just observe that consumers are by and large a very trusting lot, and when people come forward, often with a lot of media muscle behind them, offering help and assistance in a financial downturn where they have credit problems, people are inclined to trust those sorts of information. So, I think it's a big job for us to teach consumers to be more skeptical, to not sign contracts or other agreements without seeking independent sources of information. One thing that we do have a lot of in this country are nonprofits, mortgage counseling and financial counseling agencies, and also HUD foreclosure counseling centers. We would urge consumers to avail themselves of those sources of independent information and counseling, and not just believe what salespeople are telling them.

And I'd also raised the issue of media responsibility in my testimony. I do believe that an awful lot of money is being invested in both television and Internet commercials to try to promote services that are questionable, including many services that charge advance fees for debt settlement or foreclosure rescue. We have heard from a lot of enforcement officials on the ground, in states like California, that an advance fee is almost a sure indicator of a scam or a service that may be suspect, so we're trying to get that message out to consumers.

We also believe that we—one of the reasons we have this profound, deep financial crisis has been sort of disarray at the Federal level, in terms of the many different regulators we have, a system that does not provide comprehensive premarket review of financial products that are introduced and intensively marketed to consumers. And for that reason, we've been supporting the Obama Administration's proposal for a consumer financial protection agency, which we think would have—would need to have very comprehensive powers to look across the entire marketplace, including at products that are competing with each other but right now are often regulated by different regulators——

Senator KLOBUCHAR. OK, thank you.

Mr. BELL. Yes.

Senator KLOBUCHAR. Ms. Greenberg? Just your reaction to that proposal?

Ms. GREENBERG. The financial safety Product Commission?

Senator KLOBUCHAR. Yes.

Ms. GREENBERG. We're—we join with the testimony that—of the other consumer groups—testified on. I guess they're testifying today in the Senate. I just—you know, it occurs to me, I really think, Senator Klobuchar and other members of the Subcommittee, that—you know, we talked about what happened with the USPIS spending \$12 million, which was actually ill-gotten-gained money, so it wasn't taxpayer money—that we really have to go toe-to-toe with these fraudsters. That means they are spending billions of dollars reaching out—you know, hundreds of millions of dollars reaching out to get—to entrap consumers. We have to use the same methods that they use to—whether it's newspapers, whether it's magazines—to—whether it's the Internet, whether it's using Twitter or Facebook—they're very successful at this. And we—

Senator KLOBUCHAR. So, you mean we have to be as sophisticated as the crooks we're trying to get.

Ms. GREENBERG. Absolutely. And we—and once those messages get out there, people listen. The problem is, they just don't hear enough from us, but they do hear from the fraudsters.

Senator KLOBUCHAR. Right.

Mr. Vladeck, in your testimony, you talked about scam artists that have been attempting to exploit the American Recovery and Reinvestment Act by claiming to offer consumers, for a price, help with applying for, supposedly, free government grant funds. And you've mentioned that the FTC has kind of taken that on. Could you explain that, and also maybe get at Ms. Greenberg's point about how we're going to be as sophisticated as they're developing new techniques over the Internet?

Mr. VLADECK. Well, let me invite you to come look at our Internet lab which is truly state-of-the-art. We are using that to try to track and figure out who the proponents of these scams are, so that we can find them and we can go after them.

As you know, the stimulus money is like honey to scam artists. They are using, as Attorney General Koster noted, all of the trappings of government to portray their services as related to the government. Indeed, there was an Internet scam that stole people who went to the HUD website and captured that traffic, and the FTC was able to get an injunction to stop this scam quite quickly. But, most of the scams that we see are related to grant money, and so, we've brought a series of cases, and where we have other investigations ongoing to try to go after these grant scams that promise people easy access to government grants to pay off their own debts. And we've been very successful, so far, in stopping some of the big ones. But, it's like playing Whack-a-Mole. We go after some of the big ones, and another one of these scams emerge. And as long as there is this talk of the government stimulus money, I think we're going to be in the business of going after these scam artists.

Senator KLOBUCHAR. OK. Thank you very much.

Senator PRYOR. Thank you.

Ms. Greenberg, I'd like to start with you, if I may. And we'll just do a second round of questions, here. We'll do 5 minutes again if it's OK with the Senators.

But, you had mentioned that you would like access to the Sentinel database. And I'd like to get your concept of how that could work and should work.

Ms. GREENBERG. Well, this will be a familiar theme for you since it relates a little bit to how we tried to get into the Consumer Product Safety Commission database. And you've spent so much time and done such great work in that area. Really, it's a tool for consumers to be able to do their own investigation. Here's a company, let me go check them out and see, you know, if they appear on this database and whether they've, you know, been involved in fraudulent activity. We want to get—we think consumers could benefit from having access to that information. And right now it's really a law enforcement tool. So, you know, I'd like to work with the folks at the FTC and see whether there is a possibility for doing that.

Senator PRYOR. Now, as I asked you that question, I noticed that Mr. Muris and Mr. Vladeck scrambled for their notepads there and were jotting down some notes. Did you have any comments on that, Mr. Muris?

Mr. MURIS. The Commission does a great job in creating this partnership. There are issues that I'm sure Mr. Vladeck can comment on, in terms of how the partnership works with law enforcement and some of the sensitivities. These are Freedom of Information Act and other issues.

I wanted to say, generally, Mr. Chairman, that the points about reverse mortgages illustrate exactly the point that I'm making about rulemaking. I don't know the subject matter, but, if there are, indeed, crooks, the Commission needs to get out and deal with those crooks now, and rulemaking is a distraction. If there are legitimate reverse mortgage businesses, the Commission will have a great deal of difficulty drafting a rule to separate the two.

A final brief comment. The Commission had a business opportunities rule. There are 14 million people in all your districts—Mary Kay, Amway, Avon—and the Commission thought it was writing a rule about fraud. It turned out to be writing a rule that would have put many of these people out of business, and the Commission, of course, has retreated from that. But, it's a very difficult process. There already are rules. If indeed these reverse mortgage people are scam artists, there's an elaborate law of deception, and let's get on with the business of going after them and not the distraction of rulewriting.

Senator PRYOR. Mr. Vladeck, did you have a comment about the database? And I do want to ask you about his point on reverse mortgage.

Mr. VLADECK. OK. Well, let me start with the database. I share Ms. Greenberg's concerns about public availability, but there are tremendous practical problems that we need to overcome. We have personal identifier information in many of the complaints, and there are deep, entrenched privacy concerns about letting the database be searched by members of the general public.

In order to take out the fields that might contain personal identifying information, we would have to, I am informed, manually go through the database and block that information out.

I completely agree with giving the consumers access to information that might help them make informed choices. At the same time, we depend so heavily on consumer complaints for our enforcement efforts. A huge volume of complaints gives us an indication that this is a widespread scam causing serious consumer injury. The last thing in the world anyone wants is for us to deter any individual from filing a complaint or for any law enforcement agency sharing complaint data with us because of privacy concerns. And so, I'm always happy to sit down with Ms. Greenberg and talk about this issue, but I—I'm fearful that, until we can overcome the legitimate privacy issues, general public access to our database is not possible.

Senator PRYOR. Well, let me—thank you—and let me follow up on the reverse mortgage issue that he raised. Could you give the Subcommittee a sense of—or maybe a specific example of practices that you're seeing out there that you cannot currently deal with because you don't—because you would need to make a rulemaking?

Mr. VLADECK. Well, let's take the advance fee issue. I think there's general agreement among consumer advocates that these advance fees for foreclosure rescue or mortgage scams or debt scams—debt counseling scams—are principal indicators of a scam. We have gone after mortgage rescue scams and credit repair scams that charge an advance fee. I think that the best way to have tackled this problem—and we're doing it now through a rulemaking authorized by Congress—is to set a clear rule. We cannot, the states cannot, local governments cannot, go after all of these scammers. If there was a clear rule that simply said “no advance fees” in these mortgage rescue situations—and some states—my understanding is, many states are now passing state laws that require that, we would be better off. And Congress has authorized us to do that, but we've lost an awful lot of time.

Mr. VLADECK. An awful lot of people have been hurt because of the delays in our ability to get this rule on the books.

Senator PRYOR. Mr. Muris, did you have a follow-up?

Mr. MURIS. If there are legitimate businesses here, and Mr. Vladeck made a speech and said, “We will attack anyone with advance fees,” they would stop doing them. The other people are crooks, and a rule isn't going to help. The crooks are crooks to begin with. They know they're crooks, quite frankly, and you don't need a rule to deal with them. In a speech or a case, the FTC could—for the legitimate businesses—accomplish the purpose that he wants.

Senator PRYOR. Senator Wicker?

Senator WICKER. Thank you. And I'll observe, Mr. Chairman, that this hearing is even more interesting than I expected it to be, and I appreciate the panel dealing with us on this.

We have two items of agreement between Mr. Vladeck and Mr. Muris. One, that rulemaking is a distraction. Mr. Vladeck, I believe, would contend that it's a distraction that's worth it in certain limited instances. The second bit of agreement that I'd like to ask both of you about is to tell us exactly what the experience of the 1970s teaches us and how did the FTC fail? I guess since you brought it up, Mr. Muris, I'll let you go first.



Mr. MURIS. I was there. The first job I had out of law school, was as a staffer in the Federal Trade Commission. The Commission took upon itself—and frankly, it was pushed early in the 1970s by Congress—to transform entire businesses. And, as I said, it issued a rule a month for 15 months. A big part of the problem was, obviously, that the rules were not well thought out. Congress reacted and required the FTC, because it has such enormously broad jurisdiction and is not an expert agency on a specific area, like the EPA or the SEC—Congress said, “You have to have tougher procedures. And what you need to do is allow disputed issues of material fact and allow”——

Senator WICKER. Tougher rulemaking——

Mr. MURIS. Yes, tougher rulemaking procedures. And those procedures work, if you use them appropriately. I’m not opposed to rules. My 15 minutes of fame in life was the creation of the National Do Not Call Registry. We did that with a rule. We did it quickly. I believe that we could have used these procedures and accomplished it. A problem is, if you go ahead with this reauthorization and it passes the Congress, I predict—and I suspect that you all may try to stop some of this—but I predict that it will be like the FACT Act, the Fair Credit Reporting Reauthorization. It will come with a request for the Commission to do a dozen rules, and that would be an enormous distraction and disservice to American consumers. And——

Senator WICKER. Why did Congress react? Were they hearing from the people——

Mr. MURIS. Congress reacted for a variety of reasons—because the FTC was doing so much, and because the FTC’s jurisdiction is so broad. Again, if you take the EPA or you take the SEC or you take the FCC, they’re expert agencies over a relatively narrow area. The FTC is an expert, but it’s an expert on consumer protection and how to interpret advertising and how to go after fraud. In a specific area, like the mortgage area that Director Vladeck is discussing, the Commission has exactly a handful of cases dealing with, for example, mortgage servicing, yet they’re going to write a servicing rule. Instead, the way the law should develop, I believe, is for the Commission to bring cases and follow the common-law process of evolution. Because at the beginning, particularly in an area you don’t understand, it’s very hard to start a rule and to do the rule right.

Senator WICKER. Mr. Vladeck, what do you have to tell us about the failure of the 1970s approach?

Mr. VLADECK. Well, fortunately, I was not really present at the early days of the FTC. I’m a little younger than Tim. I think Tim is accurately portraying the lesson, which is that the agency overreached, and it overreached and was punished by Congress for overreaching.

I think Congress’s punishment did not fit the offense. That is, we’ve been saddled with a rulemaking process that is unlike that used by every other agency. It requires, essentially, a trial-type proceeding to finalize a rule. And make no mistake, it would take years to promulgate a rule under those conditions, which is why the agency, by and large shies away from rules like that, particularly in areas like the one we’re seeing now, where there is a fast-

developing crisis that jeopardizes consumers. The problem here is that the economic downturn has given fuel to scammers who prey on the most vulnerable in our society. And while we can go case by case, which is what we're doing, it's the difference between being able to do something wholesale or resale. We're—retail—we're doing these, case by case by case. We've made inroads. But, the more efficient, the quicker way to get redress to more consumers is to place a rule in place which has the force and effect of law. The simple violation of that gives rise to an offense, it makes our enforcement much easier. We could do a far higher volume of cases, and we could do a better job protecting American consumers.

Senator WICKER. Mr. Muris, during your term as Chairman, did you have any difficulty bringing enforcement actions against scammers? Were you limited in your ability to protect consumers from fraudulent activity?

Mr. MURIS. Absolutely not. Two points. These scammers are already violating rules. We don't think of them as rules, but these common-law principles against lying, against fraud, against breaking your contract are rules. And an additional rule, I don't think would deter the scammers.

Second, you don't need civil penalties. The Commission as Mr. Vladeck said, can freeze the assets. That gets all the money that is there to get. I don't think Mr. Vladeck would spend his time, frankly—I hope he wouldn't—writing rules against fraudsters. But, the premise that he just made was the premise of the 1970s: We need to write rules, and then we'll bring cases enforcing the rules. Because we already have basic rules of the road, the rules the FTC, indeed, writes—and it should write some; I believe Do Not Call was a great example—should be few and far between. The procedures that they have are adequate.

But, in special cases, perhaps Congress, in its wisdom, should say, "Go ahead and use APA procedures." The Commission can already go to Congress to get that done, in the rare case if the Commission believes it should do a rule.

Senator WICKER. Well, I have one final line of questioning. And that goes to Mr. Muris's point with regard to private attorneys—to Attorneys General enforcing State laws. We know that some of these Attorneys General turn around, then, and hire private attorneys to litigate claims. Mr. Muris, clearly you are fearful that further expansion of this authority presents problems. How has the practice by State Attorneys General to retain private attorneys affected the implementation of Federal law? And what needs to be done to ensure that enforcement in this regard is consistent and fair?

And then, Mr. Koster, as Attorney General, I'd like for you to weigh in on responding to Mr. Muris's point, then.

Mr. MURIS. Well, let's be clear what we're discussing. First of all, I'm not discussing the day-to-day work of the Attorneys General with their own staff. My experience has been spectacular. I could talk for days about the excellent cooperation in antitrust and consumer protection. We're talking about a problem that has arisen recently in a few states with the outsourcing of litigation responsibilities, particularly coupled with contingent-fee contracts, and some

of them to significant campaign contributors. I think that's a very dangerous situation. And if Congress—if you, indeed, increase the authority of State Attorneys General to enforce Federal laws, you should put in place guidelines for transparency, and fairness in dealing with outsourcing. That's what I'm suggesting.

Senator WICKER. Mr. Koster?

Mr. KOSTER. I've agreed with everything Professor Muris has said today, with the exception, perhaps, of this point. The reality is that General Cuomo, in New York, is a different type of Attorney General because he has so much more power than the rest of us have out in the states. I have 20—no, I have 17 lawyers in my consumer division. He is able, in New York, to take on the kinds of cases that you probably think that every Attorney General in the country can take on just by flipping on a switch in their AG's office. In many of these cases, the scope of the litigation is so large that to ask two or three \$42,000-a-year attorneys in the Midwest to take on an auction-rate securities case against Merrill Lynch or another large investment bank is nearly impossible. There are a variety of types of consumer cases that are sort of outside the scope of what we've been discussing here today, which are smaller-type cases, but the auction-rate security cases around the country are just as much a consumer case as these reverse mortgage cases that affect smaller consumers.

Having a position of strength where you can release power into the litigation marketplace and accomplish larger consumer ends, I think, is something that the local political process should be allowed to work itself through and would be ill-advised for Congress to constrain.

Senator WICKER. Even in regard to transparency and in this specific issue of large contingency fees to campaign contributors? You would rather the Congress be hands-off there and allow each state to make those decisions?

Mr. KOSTER. Speaking for my own state, I believe that a transparent Request for Proposal process should always be utilized with regard to the awarding of contracts. But, the local political process does tend to work its way through these issues, and politicians who give contracts to political friends without an RFP will have to answer for those actions when it comes time for elections.

Senator WICKER. And finally—and the Chair has been indulgent—Ms. Greenberg mentioned that the FTC staff has been reduced in real numbers. Mr. Muris, did you preside over that? And are you saying that we don't necessarily need to fund the staff back up to the 100-percent level that we had years ago without adequate training?

Mr. MURIS. Here's the problem of the 1970s. Congress gave the Commission so many resources so fast that the supervisors could not adequately control, and you created individual fiefdoms of people who were essentially on their own. I supported an increase in resources when I was chairman. We increased from 1,000 to something—I think now it's about 1,100. You should recognize that, in normal times, with that 1,100, the Commission will lose something like 100 a year. And that means you've got to hire a lot of people just to stay still.

So, I'm not opposed to adequate resources or measured increases, but I think to repeat the 1970s and throw a bunch of money at the Commission would be a mistake.

Something that needs to happen, and something we did—and Do Not Call was a great boon to this involved Consumer Sentinel. We completely rebuilt Consumer Sentinel, spent a lot of money to do that, money that we got from Congress. It has been a few years since that happened, and technology changes. I don't know if Mr. Vladeck wants that money again, but at some stage it will need to be rebuilt to keep up with the most modern enforcement techniques. So, it's not just people; it's support, as well.

Look, I'm an FTC guy. I've spent my life in and out of the Federal Trade Commission. I believe strongly in the FTC's mission and the way the FTC is now. And I certainly believe that it needs adequate resources.

Senator WICKER. Thank you.

Senator PRYOR. Senator McCaskill?

Senator MCCASKILL. I am just—curious. I want to make sure I understand. Are you complaining, Mr. Muris, about States Attorneys General working to enforce Federal law, and worried about contingent fees and contract lawyers?

Mr. MURIS. Yes, that is my point. There should be guidelines and transparency. There are Federal rules about contingent fees. The Federal Government occasionally outsources, and I think only in the dire situations should you use contingent fees. We certainly ought to have transparency. The so-called Pay for Play money to campaign contributors, that's—

Senator MCCASKILL. We've—

Mr. MURIS.—that's the sort of thing that shouldn't happen.

But, again my relationship and the relationship of the FTC with the states has been—the only word to describe it, again, has been spectacular.

Senator MCCASKILL. Well, I'm just—I just am very reluctant—I always find it ironic when folks start talking about the situational—of when the Federal Government should interfere with states. The notion that an elected Attorney General needs the Federal Government to tell him how to conduct the business of his office in a way that is going to provide transparency and accountability to the people he serves, or she serves, it seems to me the heavy hand of the Federal Government. And I think that those people—those Attorney Generals who engage in inappropriate Pay to Play contractual arrangements with campaign contributors will hear the wrath of the voters at the ballot box and will hear the wrath of their constituents at the State level. And frankly, I'm reluctant for the heavy hand of Federal Government to interfere with those State officials. I don't think, frankly, that's our place.

Mr. MURIS. But that's why the premise of your question is what I'm discussing. When they have the authority to enforce Federal regulations is when I would apply the kind of rules that apply to Federal regulators.

Senator MCCASKILL. It's just always situational when we think Washington knows best, and when we don't. So, I think this is one of these situations where Washington probably doesn't know best.

Thank you, Mr. Chairman.

Senator PRYOR. Thank you.

And I just have a couple of follow-ups just to—in the spirit of closing the loop on a couple of points.

Mr. Vladeck, with you, you've heard Mr. Muris say, a couple of times, that we basically—the current law is sufficient; we have common-law, case-by-case enforcement, and that should be sufficient. Nonetheless, you still are saying that you need the ability for rulemaking and to change the Magnuson-Moss procedures that you live under. Could you just respond to what Mr. Muris says, and tell us why you think—given what he says, case-by-case common-law—give a—tell us why you think your idea is better for the American consumer.

Mr. VLADECK. Let me be intensely practical. Without a rule in place for each case, we have to prove the elements of a violation under Section 5 of the FTC Act. If there's a rule in place, we have to show a violation of the rule. Now, anyone who's ever litigated a case—and I've spent 33 years as a litigator—wants to litigate the second case, not the first. The proofs are quicker. It allows for more orderly dispensation of justice. It allows us to go after the scammers quickly, efficiently, and to bring more cases. If we have to go case by case and prove FTC Act violations each time, we will do it, and we are doing it. That's why there are long lists of cases of mortgage foreclosure rescue scams and so forth. But, the nature of the litigation is very different. And having a rule in place—and a rule of the kind that we are likely to promulgate under the mortgages does not simply reflect the rules of fraud, as Mr. Muris claims, they embellish the rules of fraud. They clarify and bring into context the rules that we believe ought to apply. And on this issue, I think there's widespread agreement that the scam artists who are bilking American consumers, by and large, do it through up-front fees.

Senator PRYOR. Yes.

Mr. VLADECK. So, we can simply adopt a rule—we may or may not, but we could adopt a rule the way states have done, saying that any up-front fee is a violation of our rule. And it simplifies the litigation, frees us to do more of these cases more quickly, and better protect American consumers.

Mr. MURIS. Mr. Vladeck is wrong, on two accounts.

First of all, FTC deception standards, which the fraud cases apply, are strict liability.

Second, to get civil penalties under a rule, you have to prove scienter, in any event, because that's what Congress has required and that's what it should require.

The problem actually is worse than I thought, in hearing Mr. Vladeck. If he wants the FTC to distract itself and write rules against fraud, that would be a much bigger mistake than I thought the FTC had proposed for rulemaking. Again, it's strict liability already.

Mr. VLADECK. With all respect, we have to prove fraud in order to get strict liability. We don't have—prove violation of rule.

Mr. VLADECK. Second, the rule that we are looking at for mortgages would adopt a rule against advance fees. That is a rule that would permit us to litigate these cases more quickly.

And third—

Mr. MURIS. No.

Mr. VLADECK.—we're not talking about civil penalties, here. That's a different issue. I don't quite understand why Mr. Muris wants to conflate the two.

Mr. MURIS. Well, I wrote the FTC's deception standard, David. It is strict liability.

Second, if you have a rule, civil penalties is what you get under the rule. And civil penalties require scienter.

Senator PRYOR. Well, it sounds like we have an honest disagreement here, and we're not going to solve it today. But, I really do appreciate your input.

My last question is really more in the form of a request. And I think everybody on the panel has mentioned the importance of outreach and educating the public. I would hope that you all would give us your thoughts as we go forward about how to best do that and how to be the most effective and get the best bang for the buck. And also, I think we have to think about—even though it would be unpopular in some circles—we have to think about the Internet component to fraud today. There are a lot of Internet companies that are very legitimate name-brand companies that are permitting some of these fraudulent schemes to either pay for advertising on their sites or at least show up on their sites, one way or another. So, there may be some Internet component to this that—you know, again, we're not—none of us, I think, are experts in that. But, I do think it's something that we need to consider as we move forward.

I want to thank everybody for being here today. This has been a very, very informative discussion. I know that we had several Senators that were coming and going for committees. Thank you very much.

And with that—we'll leave the record open for 2 weeks, allow members who weren't here to ask questions and do follow-ups. Appreciate your responses on those.

Senator PRYOR. We'll adjourn. Thank you.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

## A P P E N D I X

PREPARED STATEMENT OF HON. TOM UDALL, U.S. SENATOR FROM NEW MEXICO

The economic challenges we face as a nation have resulted in increased fraud and consumer scams. Fraudsters are taking advantage of consumers, senior citizens, job seekers, and other vulnerable people at a time of economic hardship for many Americans.

My state, New Mexico, has been especially hard-hit by employment-related fraud. These deceptive schemes offer New Mexicans easy work, high wages for unskilled labor, and other attractive opportunities. As a result of the fraud, New Mexicans lose money, time, and other valuable resources at a time when they need them most.

The recent Federal Trade Commission (FTC) sweep to crack down on fraud—"Operation Short Change"—is a promising example of Federal and state agencies working together to protect consumers against fraud.

But this action is not enough. Americans need more than the occasional high publicity raid to fully protect them from a wide range of fraud and consumer scams.

The FTC must develop a sound strategy for protecting consumers that coordinates efforts among the Department of Justice, state attorney generals, and state agencies.

Greater cooperation among Federal and state officials will be necessary to combat those who seek to take advantage of people in this current economic climate.

This Committee plays an important role in the fight. We must ensure that the FTC has both the authority and resources to be the "nation's consumer protection agency."

I thank the witnesses for joining us today and look forward to their testimony and recommendations for how the FTC—and all of us—can do a better job of protecting Americans against fraud.

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RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. TOM UDALL TO  
SALLY GREENBERG

*Question 1.* What is the appropriate level of voluntary industry self-regulation?

Answer. The development of sound self-regulatory standards for consumer products and services helps ensure the physical and economic welfare of consumers. Self-regulation helps industry players know what the norm is for actions within their industry. It sets parameters that help to identify bad actors within the industry. It also encourages industry to condemn bad actors and take action to address the issue. NCL strongly supports industry self-regulatory models that include competent consumer contributions to the development of product and service standards. Such consumer input should be applied in the development of both mandatory and voluntary industry self-regulation standards.

With regards to advertising industry self-regulation, NCL believes the standards and rules set by the industry should reflect the following core principles:

- The goal of self-regulation should be to promote policies and standards that better inform consumers of product and service performance characteristics.
- There should be an endorsement and support of the role that strong and effective government regulatory and enforcement agencies play in overseeing industry.
- There should be an acknowledgment that disclosure alone is never an acceptable substitute for quality safety standards and careful design and production of the advertised product.

To the specific question of the level of voluntary industry self-regulation, we support vigorous industry-based review of all advertising, including in the new media market. Unfortunately, we find that the advertising industry too often fails to bal-

ance the competitive desires of the standards—making body’s members against need for consumers to understand the true nature of a product or service advertised.

Time and again, it has been shown that when consumers are presented with all the facts about a product or service in a clear, easy-to-understand fashion, they will make an informed choice. This is no less true in “new media” advertising than in traditional advertising. Unfortunately, it is apparent to our organization that advertisers too often think first of how their advertisements can give as little substantive information as possible without running afoul of government regulators. Instead, they should focus on how to properly inform their target audience to enable them to make informed choices.

It is illuminative to note that the three goals of the National Advertising Review Council, a leading advertising industry self-regulatory body, are as follow:

- *minimize governmental involvement in the advertising business.*
- *maintain a level playing field for settling disputes among competing advertisers.*
- *foster brand loyalty by increasing public Trust in the credibility of advertising.*<sup>1</sup>

That effectively informing consumers about the benefits, risks, and effectiveness of products advertised is not mentioned as a goal indicates to us that the self-regulatory objectives of the advertising industry may be insufficient. Further, given the opposition shown by the advertising industry to even the modest revisions proposed to the Federal Trade Commission’s (FTC) *Guides Concerning Use Of Endorsements and Testimonials in Advertising*, we feel that there is a lack of ambition on the part of the industry to set such a goal in the future.

*Question 2.* Where do we need greater FTC authority and activity to protect consumers?

Answer. First, the proposed revisions to the FTC’s *Guides Concerning Use Of Endorsements and Testimonials in Advertising* should be adopted by the Commission. These changes are long overdue and will help to stop some of the most egregiously harmful advertising industry practices, particularly with regards to weight-loss drugs, business opportunities, and other medical services such as baldness cures.

Second, replacing the FTC’s current Magnusson-Moss Act-based rulemaking authority with Administrative Procedures Act (APA) rulemaking authority would do much to enhance the FTC’s ability to proactively protect consumers from dishonest advertisers. For example, under its current rulemaking regime, when the FTC takes action against a dishonest advertiser, such an action requires a lengthy investigation that all too often leaves inordinate amounts of time for dishonest marketers to reap the rewards of their bogus advertisements. We believe that APA rulemaking authority would allow the FTC to much more quickly take action against dishonest marketers and thus protect more consumers, particularly in the ever-evolving new media landscape.

Finally, we would endorse more FTC activity to initiate actions against deceptive advertisers. Unfortunately, the FTC’s stretched resources have in recent years forced it to only choose high-profile targets, relying on the media exposure gained from its actions to attempt to scare other bad actors out of the market. Given the proliferation of advertising we find to be manipulative at best and fraudulent at worst, especially online, we do not believe that this strategy is sufficient to control the problem. While a more vigorous rulemaking authority would give the FTC the legal tools it needs to tackle fraudulent advertisers, the agency will also require the sufficient financial and staff resources to support vigorous enforcement.

*Question 3.* Does the FTC need new authority to protect consumers in a new media landscape that includes Internet videos, web blogs, and Twitter accounts?

Answer. NCL supports the inclusion of new media content channels such as blogs and viral video in the *Guides Concerning Use Of Endorsements and Testimonials in Advertising*. We believe that consumers are increasingly relying on such new media outlets to inform themselves about products and services in the marketplace. The increasing resources advertisers are devoting to these advertising channels, suggests that they are of a similar mind on this issue.

Given the complexities of the new media landscape and the evolving nature of user-generated content we believe the revisions to the FTC’s *Guides* are a good first step in ensuring that these new advertising channels do not become a haven for deceptive advertising. We would urge the Commission to remain vigilant and periodically review the effectiveness of its policies regarding testimonial advertising in user-generated content to determine if greater authority is needed in the future.

<sup>1</sup>National Advertising Review Council. “About the National Advertising Review Council (NARC),” Accessed August 21, 2009. Online: <http://www.narepartners.org/about/index.aspx>.



RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. TOM UDALL TO  
DAVID VLADECK

*Question 1.* Mr. Vladeck, what lessons learned for the FTC have come from “Operation Short Change”?

Answer. The lesson learned from “Operation Short Change” is that law enforcement sweeps continue to be highly successful in halting fraud and educating consumers about how to avoid, prevent, and report fraud. Operation Short Change brought together Federal and state partners to demonstrate that law enforcement is actively pursuing scams that prey on economically-distressed consumers.

The Commission is committed to finding ways to expand its partnership and cooperation with state and Federal law enforcement and consumer protection agencies. In particular, the Commission works closely with the Department of Justice’s Office of Consumer Litigation, the U.S. Postal Inspection Service, and numerous state attorneys general. These relationships have been fostered and forged through involvement in past law enforcement sweeps, information-sharing on specific cases or investigations, communication with the Commission’s regional offices, and ongoing involvement in multi-agency task forces. In addition, staff routinely works with the National Association of Attorneys General (“NAAG”) Consumer Protection Project to solicit and encourage participation from all 50 states in law enforcement sweeps.

The Commission has actively encouraged state and Federal law enforcement partners to utilize and contribute data to Sentinel, the FTC’s database of consumer complaints. Through Sentinel, law enforcers can search consumer complaint data, identify targets, track trends, and create “consumer alerts” to warn other Sentinel users about ongoing investigations of particular targets. Over 1,700 law enforcement agencies are currently members of Sentinel who may access complaint information on targets. The Commission is working to expand the number of law enforcement agencies that contribute complaint data to Sentinel.

*Question 2.* Is this an effective, coordinated approach that should be used regularly?

Answer. A coordinated law enforcement sweep like Operation Short Change is an important tool that has been and will continue to be used by the Commission to leverage our limited resources to halt and prevent fraud. This approach not only leads to the initiation of new law enforcement cases brought as part of the sweep, but generates a great deal of attention from local and national media outlets, which serves to educate the public about how to detect and avoid fraud. For example, 161 television news stories about Operation Short Change ran on news stations across the country, reaching more than 35 million Americans. In addition, news stories about Operation Short Change were aired on radio stations and appeared in over 30 print and online media sources.

*Question 3.* Have we seen changes in the marketplace as a result of these raids and YouTube video? If not, what follow-up is required or what else needs to be done?

Answer. The cases initiated by the FTC as part of Operation Short Change have halted frauds that took in at least \$300 million and injured over 700,000 consumers. It is too soon to determine the general deterrent effect or changes in consumer behavior as a result of the announcement of Operation Short Change and the rollout of the Commission’s consumer outreach video. In the meantime, the Commission will continue to investigate and bring cases against new perpetrators of fraud, alert the public to emerging scams, and educate consumers on ways to avoid becoming victims.

*Question 4.* I would appreciate learning the panelists’ thoughts on how best to help inform non-English speaking populations about how to avoid fraud. In New Mexico, for example, the state Attorney General now publishes bilingual “Foto Novela” picture pamphlets that illustrate how to avoid common scams. Foto-novelas have been used in other fields, such as community health and social work, with success. This format has proved effective in reaching older Hispanic adults, often the target of fraud. Are there projects like this currently under development?

Answer. Since July 2002, the FTC has focused on reaching out to Spanish-speakers to promote consumer education. Bilingual FTC staff has developed information in print and online for Hispanic consumers who prefer to receive information in Spanish, as well as those who like their information in both Spanish and English. The Commission has launched campaigns for Spanish-speakers on identity theft, online safety and security, being an informed consumer, managing money, and more. In addition, staff has developed a Spanish-language web portal where consumers can access the FTC’s complete library of information in Spanish. See [www.ftc.gov/](http://www.ftc.gov/)

*index\_es.shtml*. In 2008, the Commission's Spanish-language websites logged almost 1.5 million page views, and staff distributed more than half a million Spanish-language publications.

*Question 5.* Do you have any other ideas or thoughts on how to improve public outreach to non-English speaking consumers?

Answer. The Commission believes that it is vital to reach out to non-English speaking consumers using a variety of channels, including Hispanic media outlets, national Hispanic organizations, as well as state and local organizations. To that end, the Commission employs two full-time bilingual staff who regularly appear on nationally televised morning programs on Univision and Telemundo to deliver consumer tips to millions of viewers. Staff also conducts interviews for local and national TV and radio programs, newspapers, and websites. This ongoing relationship with Hispanic media outlets results in regular coverage of all our enforcement action announcements and educational campaign launches.

In addition, the Commission works with national organizations that serve Hispanic communities to disseminate consumer materials. National partner organizations include the National Council of La Raza and its Housing Network Agencies; League of United Latin American Citizens; Cuban American National Council; Hispanic Chamber of Commerce, Labor Council for Latin American Advancement; and American GI Forum, among others. Similarly, staff has actively worked with local consumer protection agencies and the Hispanic affairs offices of many governors and mayors, as well as the staffs of the Congressional Hispanic Caucus Institute and the Congressional Hispanic Leadership Institute.

In order to promote financial literacy among young adults and high school students, the Commission has worked with community colleges in Miami, New York, Cleveland, LA, and Phoenix and the New York City Department of Education to disseminate *Getting Credit*, in Spanish and in English.

Using its database of more than 1,500 organizations that serve Hispanic consumers across the country, the Commission updates community leaders about the latest issues in consumer fraud so they can pass on the information of protection to their community members. The Commission sends out regular notifications of case announcements, new consumer publications, and *Ojo!*, the FTC's newsletter for Hispanic communities that includes articles in Spanish and in English on relevant and current consumer issues.

These are just a few examples of the new and innovative ways the Commission is reaching out to the public, including non-English speaking consumers, to educate them on how to spot the signs of fraud and report fraud when it occurs.

