TESTIMONY OF

JEREMIAH S. BUCKLEY* ON BEHALF OF

THE ELECTRONIC FINANCIAL SERVICES COUNCIL

AND

ERIC CUNLIFFE** ON BEHALF OF LENDINGTREE

BEFORE

FEDERAL TRADE COMMISSION
OFFICE OF POLICY PLANNING
PUBLIC WORKSHOP ON E-COMMERCE
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The Electronic Financial Services Council ("EFSC") and LendingTree, Inc. ("LendingTree") appreciate this opportunity to participate in the Federal Trade Commission's (the "FTC") public workshop on "Possible Anti-Competitive Efforts to Restrict Competition on the Internet" and are submitting this statement on behalf of both organizations. The EFSC represents many leading companies offering financial services over the Internet, including LendingTree. LendingTree is an Internet-based lending exchange that connects consumers seeking mortgage loans, other credit products or real estate brokers with a network of banks, mortgage lenders and real estate brokers.

The EFSC and LendingTree commend the FTC for undertaking this process to identify, and hopefully urge revisions to laws and regulations that stand as impediments to the further development of electronic commerce.

LendingTree and other EFSC members have experienced significant expense, delay and frustration in their efforts to offer their services to consumers via the Internet as a result of a variety of "legacy" laws and regulations designed to facilitate face-to-face, paper-based transactions, but which now stand as barriers to competition and the fulfillment of the opportunities available through electronic commerce. The EFSC and LendingTree both welcome the opportunity to better facilitate the use of electronic commerce as a medium delivering financial services to consumers more efficiently and economically.

As a general proposition, the EFSC and LendingTree believe that the Internet, and the electronic commerce revolution currently underway, represent one of the purest manifestations of interstate commerce that could have been envisioned by the drafters of Constitution in granting to Congress the authority "to regulate commerce . . . among the several states." The Internet is a borderless, paperless medium uniquely suited to

* Jeremiah S. Buckley is a partner at the law firm of Goodwin Procter LLP and serves as general counsel of the Electronic Financial Services Council.
** Eric Cunliffe is Senior Vice-President & General Manager of LendingTree.

facilitate commerce among the states and with other nations. Although the federal system of government by which the various states retain authority to regulate local activities is and will continue to be a principal source of law and regulation governing commercial activities in this nation, there must be a recognition by the states and the federal government of the need for clear, consistent and certain national standards for regulating commerce in this electronic era. While the EFSC and LendingTree support an appropriate role for the states in the regulation of electronic commerce, we suggest that the federal government has a unique responsibility, and indeed the Congress has a Constitutional obligation, to reduce or eliminate those elements of state and local regulation that unduly burden interstate commerce and to provide the sound legal framework necessary to facilitate the free flow of interstate commerce through the Internet and other channels of electronic commerce.

Our comments focus on state law and regulatory barriers to electronic commerce in the financial services industry, specifically the mortgage brokerage and real estate industries. With respect to state barriers, we will address: (i) the complex and often inconsistent process for obtaining licenses and other regulatory approvals to operate on a nationwide basis; (ii) state laws mandating the operation of in-state offices and the use of local agents; (iii) state real estate brokerage regulations that have an anti-competitive impact on online service providers, like LendingTree, and prevent consumers from realizing the full benefits of LendingTree's services, and (iv) state appraisal board actions that may be impeding the use appraisal alternatives or computer generated estimates of value otherwise known as AVMs.

The Need for Uniformity of Licensing Requirements

By transmitting information over the Internet, a company may, from a single location, enter into a consumer transaction in any and every state. A threshold question is whether the transaction occurs in the state in which the consumer is located, or at the location from which the electronic message originated (which may not necessarily be where the company transmitting the message is physically located and licensed). Most states that we have encountered believe that the transaction is deemed to occur in the state where the consumer is located. Also, in some cases, such as residential mortgage loan transactions, state jurisdiction follows from the situs of the property securing the loan, even if neither the borrower nor the lender are residents of the situs state. As a result, mortgage brokers, mortgage lenders, and real estate brokers are typically required to obtain separate licenses or other regulatory approvals in each state in which they do business.

While the difficulties associated with 50 or more different licensing laws predate the existence of the Internet or the conduct of business by electronic means, the ease of access to a nationwide market made possible by new technologies such as the Internet, heightens the need for greater uniformity in the licensure and regulation of financial service providers. The Gramm Leach Bliley Act of 1999 was an important step towards the elimination of unduly burdensome and unnecessary regulatory barriers for the banking sector of the financial industry. We believe similar progress needs to be achieved in the mortgage and real estate industries.

Regulations governing the brokering, making, and servicing of residential mortgage loans, home equity loans and consumer loans vary significantly from state to state. Each state has at least one, and in some cases two or more licensing laws applicable to the mortgage and consumer lending business. There is no consistency of definitions of the activities subject to licensing or the categories of companies eligible for exemption from licensing. A company doing business on the Internet seeking to become licensed to offer first and second mortgage loans in all 50 states and the District of Columbia must complete 50 to 75 separate license applications, obtain multiple surety bonds, provide similar corporate, personal and financial information on its officers, directors, and investors on separate forms for each state, and undergo extensive and repetitive background investigations. Although each state reviews roughly the same information when considering license applications, there is no uniformity with respect to how the information is gathered, processed or analyzed, nor is there an effective system by which states can access the information obtained by other states to reduce the redundancies of the current system.

As a result of the inefficiencies of the multi-state licensing process, a company seeking national lending authority may require up to a year or more to obtain all the licenses required to operate. The direct cost of this process is significant as well, running as much as $500,000 or more in terms of state filing fees, bond premiums, auditors' fees, registered agent expenses, and legal fees. The indirect costs associated with the current multi-state licensing system, such as the diversion of extensive corporate and administrative resources and the opportunity costs resulting from the lengthy time to obtain nationwide authority to conduct business, are more difficult to quantify, but are undoubtedly significant as well. Corporate officers, directors and investors can expect to be called upon repeatedly to provide detailed personal, business and financial information, and to provide fingerprints for multiple criminal background investigations. In addition, once licenses are obtained, companies must incur significant costs and devote substantial administrative resources for functions related to the upkeep of licenses, including annual license renewal procedures, the completion of annual reports of lending activity and financial results, general regulatory compliance and management of state examinations, and the payment of annual fees and assessments.

The EFSC and LendingTree would urge the FTC to consider the advantage of a national licensing law for lenders and brokers offering residential mortgage loans and other consumer loans. For example, legislation could be enacted by Congress to encourage states to adopt, within a specified time period, uniform licensing laws or a system of reciprocity under which a license issued in one state is recognized in other states, provided that the laws applicable in the "home state" of the licensee meet a minimum threshold standard of regulation and oversight. Unless a significant majority of states adopt either a uniform licensing law or provide reciprocity for licenses issued in other states, it would be appropriate for a federal licensing system to be implemented system.

A precedent has been set in the insurance industry for a mechanism to encourage states to adopt a uniform, national licensing system for persons who sell or solicit the purchase of insurance. The Gramm-Leach-Bliley Act contains provisions (see Sections 321-336) that require states to act within three years either to adopt uniform licensing laws or to enact reciprocity laws governing the licensing of nonresident insurance agents. If a majority of states fail to act within three years, a national registration scheme, known as the National Association of Registered Agents and Brokers ("NARAB"), will be implemented. An insurance agent who registers with NARAB would be able to be licensed in any state without regard to state residency requirements so long as the agent pays the requisite license fees and meets applicable bonding requirements. The EFSC and LendingTree suggest that consideration be given to extending the NARAB model to other segments of the financial services industry, such as mortgages and real estate, that are plagued by similar licensing inefficiencies inherent in the current non-uniform, multi-state licensing system.

In-State "Bricks and Mortar" Office Requirements are Unconstitutional and Clear Barriers to Electronic Commerce

In several segments of the financial services industry, a host of state laws exist which require financial service providers to maintain offices in-state or employ local residents as employees or agents. While some of these laws are legacies of an era where it was valid to assume a transaction would occur in person, others were clearly intended to relieve local companies from the pressures of out-of-state competition. The EFSC and LendingTree believe it is appropriate for the federal government to exercise its authority to regulate interstate commerce and block enforcement of these state laws that unduly burden commerce among the states and that are antithetical to the concept of the Internet as an electronic marketplace free of the expense and inconvenience of physical places of business.

In the mortgage industry, approximately 30% of states require companies that make, broker or service first mortgage loans establish an in-state office before becoming licensed. Among the states with these so called "bricks and mortar" requirements are Arizona, California, Georgia, New Jersey, Ohio, Pennsylvania, and South Carolina. In-state office requirements no longer serve any legitimate public policy purpose, such as consumer protection, but rather impose an undue burden on interstate commerce in the mortgage industry. Requirements for companies to maintain offices or employees in a particular state cannot be justified by business necessity and are out of sync with new technologies and business models that permit the accurate, convenient, and efficient communication of information to consumers via the Internet, centralized call centers and express mail.

Without discussing the specific bricks and mortar rules for each state (which are summarized on attached Exhibit A) it might be useful to consider the requirements in South Carolina's mortgage broker statute as an example of the burden these requirements impose on all mortgage companies operating nationally from centralized locations, using the Internet or other communications media. South Carolina law requires that a licensed mortgage broker maintain a physical place of business in the state, which, at a minimum, is staffed by at least one employee with authority to contract on behalf of the licensee and to accept service of process on the broker. The office must be open during regular business hours, which are defined as at least 30 hours a week from Monday through Friday. The state regulator must be notified of the licensee's hours of operations if the licensee's office is not open for business from at least 8:30 am to 5:00 pm, Monday through Friday. In light of the requirement that LendingTree incur the expense of establishing a superfluous office in South Carolina, the company has elected to not do business as a mortgage broker in South Carolina. This is regrettable as LendingTree receives numerous inquiries from South Carolina consumers seeking to avail themselves of LendingTree's services.

While requirements in other states are not as well defined or onerous, the mere necessity of a physical presence in a state is a significant burden for companies doing business through electronic commerce. Companies are forced to either incur the cost of leasing offices, hiring employees and paying for equipment that they do not need and would not use but for the fact of the bricks and mortar requirement, or elect not to do business in that state. Either way, consumers are the ones that ultimately suffer as there are fewer sources of capital and less competition among lenders; and those out-of-state lenders that elect to do business in the state must incur greater expenses, which are likely to be passed on to consumers.

Unfortunately, in many states, the bricks and mortar requirements are not merely a case of old laws needing to be brought up to date. In the past several years, Georgia, Kansas, North Carolina, Ohio, Texas and Wisconsin have adopted some form of in-state office requirement for mortgage companies. In many cases, these laws are the result of lobbying efforts by local mortgage companies with the express purpose of limiting competition from lenders or brokers operating on the Internet or otherwise from out of state.

In addition to the fact that there is no reasonable business or public policy justification to support the continuation of in-state office or resident agent requirements, a compelling legal case may be made that a state law mandating that a company operate an office in state or employ a state resident as a condition of becoming licensed violates the Constitution of the United States. Under the Commerce Clause it can be argued that the mandatory in-state office regulations (1)discriminate against interstate commerce; (2) unduly burden interstate commerce, and (2) inappropriately impose state law requirements on a commercial activity that is essentially interstate.

A state regulation discriminates against interstate commerce when it provides for "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens latter." *Oregon Waste Sys.*, 511 U.S. 99 (1994). It is well settled that a state law that discriminates on its face by treating in-state and out-of-state commerce or competitors differently is per se invalid under the Commerce Clause. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 274 (1988).

In a recent Fifth Circuit case, the court noted that absent a facially discriminatory purpose, a State regulation is discriminatory when it provides for differential treatment of similarly situated entities based upon their contacts with the State or has the effect of providing a competitive advantage to in-state interests vis-à-vis similarly situated out of state interests. *Ford Motor Co. v. Texas Dept. of Transp.*, 264 F. 3d 493 (5^{th} Cir. 2001).[1] A state law that discriminates, even if only in its effect, in favor of local interests to the detriment of out-of-state businesses “invokes the strictest scrutiny of any purported legitimate local purpose, and of the absence of nondiscriminatory alternatives” and will generally be upheld only if it is the least restrictive means available to achieve a legitimate local government objective. *Hughes v. Oklahoma*, 441 U.S. at 337.

A state law requirement that a mortgage company maintain and transact business from an in-state office is discriminatory in the meaning of these cases. It treats in-state and out-of-state economic interests differently, to the detriment of the latter: Only out-of-state companies are required to establish duplicative offices not required by their business. The burden is significant: an out-of-state licensee is required to bear substantial costs to acquire, equip and staff an office even though it need not operate from a location in-state in order to run its business. Moreover, the in-state office requirement fails the courts' strict scrutiny test as it does not serve a legitimate government objective that cannot be met by less-restrictive means: Without establishing an in-state office, a licensee could submit to the state's jurisdiction and make other commitments necessary to permit enforcement of the licensing law, such as timely submission of records upon request. Furthermore, it is not appropriate for states to require that companies doing business in their state through electronic media appoint an agent for service of process in order to maintain state jurisdiction for resolution of disputes. Such a requirement would be appropriate and less burdensome than the requirement for maintenance of a loan origination office in the state.

If the regulation at issue is nondiscriminatory, then it is analyzed under the balancing test established in *Pike v. Bruce Church*, Inc., 397 U.S. 137 (1970). *Pike* held that a regulation is invalid if the burden imposed on commerce is clearly excessive in relation to the putative local benefits. States have an obvious and legitimate interest in protecting consumers who reside in their state; however, requiring out of state businesses to maintain in-state offices raises protectionist barriers without providing measurable local benefit.

Federal courts considering the validity of in-state office requirements in connection with professional licenses have consistently struck down requirements that companies maintain an office in the subject state as a condition for holding a license. See, e.g. *Georgia Association of Realtors v. Alabama Real Estate Commission*, 748 F. Supp. 1487 (M.D. Ala. 1990) (real estate brokers); *Underhill Assoc., Inc. v. Coleman*, 504 F. Supp. 1147 (E.D. Va. 1981) (securities dealers). Indeed, the Supreme Court has noted that state laws requiring business operations to be performed in-state that could be performed more

[1] Ford asserted that the need for national uniformity overrides the state’s interest in regulating the marketing of preowned vehicles via Ford’s internet site. In making this argument Ford points to the expanse of e-commerce and the need for consistent regulation. While the Court did not find Ford’s analogy persuasive in this particular case, it did concede that when considering laws which directly regulate internet activities, the need for uniformity at a national level may prevail.

efficiently elsewhere are virtually per se illegal. *See, e.g., Pike v. Bruce Church*, 397 U.S. at 145.

LendingTree is Unable to Provide Realty Services Benefits to Consumers in Certain States.

LendingTree also operates a real estate service at its website and for consumers who are members of various wholesale price clubs, airline frequent flyer programs and other co-branded websites available to the general public. This service is provided through a nationwide network of licensed real estate brokers in every state in which a license is required. As part of the program LendingTree receives cooperative real estate brokers commission for work in marketing to the consumer and delivering consumer requests for real estate listing and purchasing services. In addition to these actual services, Lending Tree also reduces the consumer's home acquisition costs by refunding a portion of their real estate commission costs. In most states the refund is provided in the form of cash, or in the case of consumers who came to us through an airline frequent flyer program, in the form of frequent flyer miles.

However, some states have statutes or regulations that make it illegal for LendingTree to provide the consumer with a cash or mileage refund. In some of these states, e.g. Oregon, Lending Tree arranges with the local broker to provide the consumer with an equivalent credit at the real estate closing. However, in certain states, for example New Jersey, many of our local broker partners have expressed a concern that New Jersey Law (NJ 45: 15- 17K in conjunction with NJ 11: 5-62) prohibits them from providing any rebate to the consumer. The net effect of such statutes and regulations is to deprive the consumer of a valuable cash refund that reduces the cost of the real estate transaction. Lending Tree has sought clarification of this issue from the New Jersey Real Estate Commission, but have received none as yet.

Appraisal Alternatives

Automated Valuation Models, or AVMs, are computer programs that use sophisticated statistical analysis to estimate home values. AVMs have been used by the residential mortgage industry now for a number of years and are highly reliable. When properly designed and used, AVMs are as accurate an indicator of residential property values as the estimate prepared by a licensed appraiser. AVM value estimates are relatively inexpensive, may be obtained virtually instantaneously, and are often used by lenders to:

- Provide an initial estimate of a borrower's equity in an existing home,
- Re-confirm or double-check appraisal values,
- Evaluate the safety and soundness of existing loan portfolios,
- Target appraisals that appear to vary significantly from market values for closer scrutiny, and
- Serve as the primary source of estimated home value for making loans secured by the borrower's residence in lieu of a full appraisal.

AVMs are particularly valuable for the processing of residential loan applications being submitted and evaluated electronically. The use of an AVM permits the application to be processed without either the delay or expense of a full appraisal. When using an AVM, it is industry practice to advise the borrower that an appraisal will not be required by the lender but that the borrower is free to obtain an appraisal independently, if they so desire.

Generally, Federal law requires appraisals for many home loans made by national banks and thrifts, however, there are a number of exceptions from the appraisal requirement, including the express authorization to use appraisal alternatives for loans less than $250,000 and for virtually all home loans eligible for sale to government sponsored enterprises, such as Fannie Mae and Freddie Mac. The laws of most states, on the other hand, do not require appraisals. However, as a matter of prudence and long standing practice most lenders do obtain some form of appraisal or home valuation. Furthermore, most states have appraisal licensing laws that do not prohibit the use of AVM for the valuation of any home mortgage loans, so long as it is disclosed that the AVM is not an appraisal and was not prepared by a licensed appraiser.

Despite the broad authorization for use of AVMs under state and federal laws, state-appointed boards that regulate appraisers in a number of states have attempted to block the growing use of AVMs through a variety of means including:

- Advising market participants that AVMs are illegal and that providers and users are subject to fines and prosecution;
- Commencing rule-making or enforcement actions without notice and hearing, in violation of applicable state laws concerning administrative due process; and
- Claiming that the mere collection of statistical data on home valuation for a company's internal use triggers the need for a state license, thus AVM providers who do not obtain a license are in a violation of appraisal licensing laws.

In Oregon and Pennsylvania, AVM providers have filed suit in federal court. In Pennsylvania, the lawsuit alleges that the Pennsylvania State Appraisal Board improperly forces banks and consumers to use appraisals instead of federally approved appraisal alternatives. Appraisal boards, which were constituted for the legitimate purpose of regulating the licensing and qualifications of appraisers are arguably being used by the appraisal industry as a tool to stifle competition, hamper economic efficiency, and impede innovative business models.

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The EFSC and LendingTree commend the FTC for convening this Workshop to highlight the burdens placed on interstate commerce by unnecessary state regulations. We look forward to working with the FTC, the Administration and the Congress in the months ahead to eliminate these and other impediments to providing consumers with the full benefits of electronic financial services.

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