Comments of the
National Consumer Law Center
(On behalf of its Low-Income Clients),
National Association of Consumer Advocates,
and
National Council of La Raza

Regarding

Federal Trade Commission
R911003
16 CFR Parts 321 and 322
Advance Notice of Proposed Rulemaking
Mortgage Assistance Relief Services

July 15, 2009

These comments are submitted by the National Consumer Law Center (on behalf of its low income clients),[1] the National Association of Consumer Advocates, [2] and the National Council of La Raza.[3] These comments are in response to the June 1, 2009 Advance Notice of Proposed Rulemaking issued by the Federal Trade Commission (FTC). The FTC requests comment with regard to prohibiting unfair and deceptive acts and practices by mortgage assistance relief services (MARS).

In summary, it would be appropriate to:

- Prohibit up-front payments for mortgage assistance relief services until an affordable, sustainable loan modification is put in place.

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[1] The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including Foreclosures (2d ed. 2007 and Supp.), Foreclosure Prevention Counseling (2d ed. 2009), and Truth in Lending (6th ed. 2007 and Supp.), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide comprehensive comments to the federal agencies on the regulations under these laws. These comments were written by Lauren Saunders, Jon Sheldon, and Andrew Pizor of NCLC.

[2] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[3] **The National Council of La Raza** (NCLR) is the largest national Hispanic civil rights organization in the United States, dedicated to improving opportunities for Hispanic Americans

- Provide a thirty-day cooling off period, with the start of the period being triggered by the provision of a written contract with notice of the right to cancel.
- Prohibit excessive fees for results achieved and fees where no service is offered.
- Strictly limit exemptions. The only exemption to the ban on advance fees should be a narrow exemption for attorneys.
- Provide a floor to protect all homeowners without preempting state protections.

I. Nature of the Problem

A. The Industry

An estimated 8.1 million mortgages are anticipated to be in foreclosure within the next four years.[3] These millions of desperate homeowners are a tempting target for scammers and those looking to make a quick buck. Beyond the numbers, however, loan modification scams are flourishing because those who are actually in a position to help–the mortgage servicers and the lenders on whose behalf they are acting–have done an inadequate job of working with homeowners. Despite widespread efforts to encourage voluntary loan modifications since early 2007,[4] the servicing industry has failed to implement a loan modification strategy on a scale commensurate with the problem. Instead, it has become clear that the mortgage servicing industry is fundamentally broken when it comes to meeting the needs of borrowers.

The servicing industry's unresponsiveness to borrowers' inquiries and its inability to provide timely and consistent information to borrowers is driving desperate homeowners into the outstretched arms of loan modification scammers. "Loan modification firms say they are taking up the slack left by unresponsive lenders and overwhelmed nonprofit groups."[4] To a homeowner, desperate to avoid foreclosure after being repeatedly disconnected, or one who cannot wait on hold for 30 minutes because she has only a 15-minute work break, a third-party that claims it can help for a fee may sound like a reasonable option. Yet, while poor mortgage servicing has left borrowers flailing and looking for a lifeline, the loan modification industry has been perfectly happy to provide borrowers with a cement life jacket.[5] As a Director of the FTC's

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[3] Credit Suisse, *Foreclosure Update: Over 8 Million Foreclosures Expected* at 3 (Dec. 4, 2008).
[4] For example, In May 2007, Senate Banking Committee Chairman Dodd announced a set of servicing principles aimed at long-term affordability. Those principles called, in part, for loan modifications that would "create a solution for the borrower to ensure that the loan is sustainable for the life of the loan." Senator Dodd Unifies Industry Members, Consumer Representatives to Help Preserve the American Dream of Homeownership (May 2, 2007), http://dodd.senate.gov/index.php?q=node/3863/print. In June 2007, Chairman Sheila Bair of the FDIC called for automatic loan modifications for borrowers with subprime ARMs.
[4] Renae Merle, Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say, Washington Post at A01 (Dec. 26, 2008).
[5] Jay Macdonald, Debtor Beware, Mobile Register, at J1 (Aug. 7, 2005) (noting foreclosure "rescuers" offer "what Harvard Law School professor and bankruptcy expert Elizabeth Warren calls 'the cement life jacket'.")

Bureau of Consumer Protection once said "[a]dvance fee loan scams are especially appalling because they prey on the most vulnerable consumers . . . ."[6]

If servicers did their work properly, far fewer homeowners would consider the for-profit mortgage assistance relief industry. Mortgage servicers should not be allowed to commence foreclosure proceedings unless they first engage in loss mitigation efforts including evaluating the homeowner for a loan modification and offering any modification for which the homeowner qualifies. Mortgage servicers should be required to give borrowers contact information for specifically identified servicer representatives who have the information and authority necessary to answer questions and fully resolve loss mitigation issues—including the power to modify loans, agree to short sales, and accept deeds-in-lieu of foreclosure.

The substantial advertising spent to promote loan modification firms obscures the message that homeowners are much better-off taking advantage of the free, better-qualified help available from HUD-approved housing counseling agencies. One website, USHUD.com, even claims to be "America's Only Free Foreclosure Resource" even though HUD-certified agencies also offer free assistance regardless of income.

Some modification firms claim superior expertise even though there are no recognized qualifications other than the training programs offered by HUD to certified agencies. Instead, some for-profit entities tout their experience as mortgage industry insiders—the same industry that caused the problems many homeowners now find themselves in.

By contrast, HUD-approved housing counseling agencies must be non-profit, IRS 501(c)(3) corporations, must complete the HUD approval process, and need to comply with HUD regulations, including requirements for trained, experienced staff. These regulations include conflict of interest provisions that require counselors to act in the best interest of their clients, quarterly reporting to HUD of performance numbers, biennial site visits and review of client files, restrictions on charging fees, and record-keeping requirements. The non-profit housing counseling industry has extensive foreclosure training programs, provided by NeighborWorks, National Council of La Raza, and HUD, along with internal training programs provided by ACORN Housing, National Foundation of Credit Counseling, Money Management International and others.[7] Attorneys are extensively trained in the law and must adhere to strict ethical rules that protect clients from conflicts of interest, ensure the safeguarding of client funds, protect client confidentiality, and impose a strong duty to act in the client's best interests. For-profit entities are under no such obligation, do not have the same educational requirements, and are subject to far less, if any, supervision.

B. Existing State Regulation

Although a growing number of states have enacted laws to address foreclosure rescue scams, FTC action is still needed. Approximately half the states lack any provision designed to

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[6] Press Release, Federal Trade Comm'n, FTC and States Launch Another Crackdown on Telemarketers Offering Credit Cards and Loans That Never Arrive (Aug. 12, 1999) (quoting Jodie Bernstein) available at http://www.ftc.gov/opa/1999/08/operationafl.shtm

[7] The National Consumer Law Center subcontracts with National Council of La Raza to provide trainers at training conferences for housing counselors.

address foreclosure rescue scams. A national ban on advance fees will dramatically improve the ability to deliver a clear message to homeowners: Do Not Pay an Advance Fee. Additionally, while the existing state laws are helpful, they were generally not adopted with loan modification scams in mind and, consequently, have a number of weaknesses when applied to loan modification scams.

The first problem is limitations in the scope of these laws. Most state laws only address services to homeowners who are in foreclosure or are 30 to 90 days in default. This type of limitation leaves many homeowners vulnerable to MARS scammers. Many homeowners have sought help from MARS before entering default, though sometimes the MARS then encourages a default.[8] The FTC should issue rules that cover all homeowners—regardless of whether they are in default. The mortgage servicing industry and others have urged homeowners to seek help before they go into default. Expanding the scope of these state laws would align the law with the widely disseminated message to seek help early. There is also no legitimate public policy reason to protect one group of homeowners from these scams but not another.

A second common weakness with state laws is that the prohibition of advance fees in many of the existing laws is easy for loan modification scammers to evade. Companies should not be permitted to evade an advance fee ban by taking the money "in trust" until the "services" are performed. If a MARS is allowed to take money "in trust" but only makes calls without achieving a loan modification, the homeowner is left unprotected. Similarly, MARS should not be able to obscure an advance fee with deceptive terminology. The paperwork for one transaction, for example, revealed that the fee was falsely described as a charitable donation.[9]

II. The Nature of the MARS Rulemaking Proceeding: Preventing and Not Just Merely Defining Unfair and Deceptive Practices

To be effective, a rule must do more than just provide a list of prohibited unfair and deceptive practices. The rule must also prevent unfair and deceptive practices where there is a significant potential of such practices occurring, despite the fact that the practices clearly violate the FTC Act.

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[8] See Prepared Statement of the Federal Trade Comm'n on "Foreclosure Rescue and Loan Modification Scams," before the House Comm. on Financial Services Subcomm. on Housing and Community Opportunity at 6 n.21 (citing *FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla., filed Mar. 24, 2009); *FTC v. Nat'l Hometeam Solutions, LLC*, Case No. 4:08-cv-067 (E.D. Tex., filed Feb. 26, 2008). *See also* Daniel Massey, *No Helping Hand*, Crain's N.Y. Business (Jan. 10, 2009), http://www.crainsnewyork.com/article/20090111/FREE/301119975/rss22; Press Release, "Brown Announces Arrest of Two Scam Artists Who Committed Loan Modification Fraud," Cal. Attorney General (Mar. 19, 2009) and attachments, http://ag.ca.gov/newsalerts/release.php?id=1702 (advised homeowners against paying mortgage or contacting servicer); California Reinvestment Coalition, *The Ongoing Chasm Between Words & Deeds V: Abusive Practices Continue to Harm Families & Communities in California* 22-23 (July 2009) (46% of housing counselors report "very common" for borrowers to say they were told not to contact servicer), http://calreinvest.org/system/assets/195.pdf; Modifications Loan LLC, http://www.modificationsloan.com (FAQ advising homeowners to make payments late in order to pay for loan modification services).

[9] Complaint, *State of Tennessee v. Tennessee Housing Protection Agency* ¶ ¶ 46-53 (Tenn. Chancery Ct., 13th Jud'l. Dist., dated Oct. 28, 2008), http://www.tennessee.gov/attorneygeneral/cases/tnhousing/THPA%20Complaint.pdf.

The 2009 Omnibus Appropriations Act, section 626, does not require the FTC to initiate a rulemaking to "define" unfair practices. Instead, it requires the initiation of a rulemaking "with respect to" mortgage loans. Title 15 U.S.C. § 57a(a)(1)(B) states that, in addition to defining with specificity unfair and deceptive practices, FTC rules "may include requirements prescribed for the purpose of preventing such acts or practices." Examples are the three-day cooling-off period for door-to-door sales and the requirement that sellers include the FTC Holder Notice in loans they assign or refer. There is no indication in the Congressional history that the FTC's authority to issue mortgage loan-related rules should be narrower than its authority to issue other rules.

In addition, 15 U.S.C. § 6102(a)(1) states that the FTC "shall prescribe rules prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices." This language is clearly more restrictive than section 626's language of "with respect to" mortgage loans, but the FTC has used this authority to prohibit advance payment for credit repair, services to recover money lost through telemarketing fraud, or loan brokerage.[10] In short, the MARS rulemaking should not only define with specificity unfair and deceptive practices, but should also include provisions to prevent such practices where it can be expected that merely defining such practices will not prevent their recurrence.

III. Prohibition on Advance MARS Fees

A. Advance Fees Are Unfair and Deceptive

NCLC encourages the FTC to ban mortgage assistance relief services from seeking up-front payments. Prohibiting up-front payments will curb the injury and unfairness caused when companies take large payments from borrowers and fail to obtain loan modifications on their behalf, whether the outfit is an outright scam or merely ineffective. Even where the MARS has honest intentions, there is no difference—from the homeowner's perspective—between a company that takes her money and runs off with it, and one that takes it, makes some futile attempts, and says "sorry, it didn't work out." Requiring these companies to obtain the promised loan modification as a condition of being paid will substantially reduce their incentive for making false or inflated promises of foreclosure assistance.

For-profit mortgage assistance relief services often require homeowners to pay in advance for loan modification assistance. Indeed, obtaining this advance fee is usually the scammer's ultimate goal, providing only token assistance to create a veneer of legitimacy.[11] In May 2009, for example, the Texas attorney general filed suit to shut down a foreclosure rescue

[10] *See* 16 C.F.R. § 310.4(a)(2) – (4).

[11] This is similar to the situation the FTC sought to remedy with the Telemarketing Sales Rule, 16 C.F.R. Part 310. "An important characteristic common to credit repair services, recovery services, and advance fee loan services is that in each case the offered service is fundamentally bogus. It is the essence of these schemes to take consumers' money for services that the seller has no intention of providing and in fact does not provide." 68 Fed. Reg. 4614 (Jan. 29, 2003).

firm using "high pressure sales tactics and false 'guarantees'" of the firm's ability to save homes "in order to extract large cash payments from homeowners."[12]

Available data also indicates that a MARS, even if legitimate, will have great difficulty providing any benefit to the consumer that would merit a significant advance fee. Assuming the most diligent efforts by a MARS, success against unresponsive servicers is likely to be just as elusive as it is for homeowners who try on their own, but far more expensive.

It is useful to put this discussion in the context of the loan modifications that servicers are actually offering. One analysis of statistics for modifications made in May 2009 showed that only 12% reduced the interest rate or wrote-off fees or principal. About 59% reduced payments (most likely by stretching out the amortization schedule with a balloon payment at maturity). That is, approximately 39% of loan modifications either *increased* payments or left the amount untouched. For the few who got write-offs, the average amount written-off was less than 6% of the loan. This contrasts with a loss rate of 65% for loans that went to foreclosure.[13] Of the loan modifications made to date, about 50% have re-defaulted.[14]

These abysmal numbers are worth keeping in mind when deciding whether it is worth encouraging an industry that charges $2,000 to $4,000 to the homeowner and cannot even guarantee any sort of loan modification; let alone one that actually delivers on the promise to avoid foreclosure. The difficulty in obtaining an affordable loan modification highlights the actual cost of for-profit modification services. Many modifications require capitalization of the borrower's arrearage. This results in either higher payments after re-amortization, or puts the borrower further underwater.[15] This means any cash borrowers have saved is better spent paying down their arrearage than paying advance fees for work that mortgage servicers and non-profit counseling agencies do for free.

It is clearly deceptive for a MARS to misrepresent its services or its success rate. But, even without an explicit representation as to its success, the act of requiring payment in advance makes an implicit representation that it can perform the service being purchased. Where there is a low likelihood of success this act is, by itself, unfair and deceptive. In today's consumer marketplace, when a seller offers to perform a service, and takes the consumer's payment up front, there is an assumption the service will be provided. Common law warranties assume it will be done in a merchantable manner. Given the recognized difficulty in obtaining appropriate loan modifications, companies making representations that they can assist homeowners in need

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[12] The scheme was launched in November 2008 when its principals incorporated Excel Loss Mitigation – even though they had "no legitimate business model, resources, or plan to actually perform any services that would help the homeowners," the lawsuit says. From its Houston office, Excel solicited business – and upfront fees of $1,498 each – from homeowners in its home state and in Florida, Nevada, California, Ohio, Michigan, Louisiana and other states. See press release and documents posted on-line at http://www.oag.state.tx.us/oagNews/release.php?id=2983.

[13] Alan White and Jonas Herrell, *Wells Fargo Columbia Collateral File Summary* (May 26, 2009) available at http://www.valpo.edu/law/faculty/awhite/data/may_09_summary.pdf.

[14] *See* Emily Flitter, *Rising Redefaults Raise Loan Mod Mandate Odds*, American Banker at 1 (May 5, 2009).

[15] Alan M. White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications From 2007 and 2008 Remittance Reports*, 36 Fordham Urban L.J. 509, 526-27, 534 (2009).

also have no substantiation for that representation. Not only is the implicit or explicit representation deceptive, but the company has no basis for making the representation.

MARS advance fees are not only deceptive but also unfair. The succeeding subsections will discuss the three part unfairness analysis, discuss how the FTC and Congress have taken similar actions in comparable situations, and examine some aspects of a limit on advance fees.

B. Advance Fees Cause Substantial Injury to Consumers

MARS fees often reach thousands of dollars.[16] Consumers sustain a substantial injury when they pay this much money but receive little or nothing in return. Not only do consumers lose money that could have been put towards their mortgage or a rental apartment, but they also lose valuable time that could have been spent pursuing legitimate avenues of relief, such as free assistance from HUD-certified agencies. Recent news accounts illustrate the problem of advance fees and for-profit modification companies:

- Queens, NY – The Middleton family with a young daughter battling cancer pays American Modification Agency $1,990 to renegotiate their mortgage loan. The company told the Middletons to stop making mortgage payments and promised a loan modification with lower payments. When the loan modification never materialized, the Middletons found themselves further behind, and their home was scheduled for foreclosure.[17]

- Chicago, IL – Ms. McClelland paid $1,300 to Foreclosure Solutions Experts to stop the foreclosure on her home and reduce her mortgage payments. Despite being told repeatedly by the company that she did not have to worry about anything, the company failed to contact her lender.[18]

- Alexandria, VA – A 75-year old retired nurse paid $2,500 to U.S. Homeowners Assistance for help in modifying her loan. After taking her money, the company failed to return her calls and her home fell into foreclosure.[19]

- Parker, CO – The Monsons paid Peoples First Financial $3,000 to keep their home out of foreclosure. The company told them not to talk to their mortgage servicer and not to make mortgage payments "so it would be easier to renegotiate." The company did nothing and the house is in foreclosure.[20]

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[16] By the summer of 2007, the Better Business Bureau reported receiving complaints from hundreds of homeowners in all 50 states who had each paid up to $1,300 to con artists promising help but doing little or nothing. Better Business Bureau, *Mortgage Foreclosure Scams on the Rise, Warns BBB: Foreclosure "Rescue" Companies May Promise to Save Your Home, but Only Empty Your Wallet* (Aug. 17, 2007), www.bbb.org/us/article/968.
[17] Daniel Massey, *No Helping Hand*, Crain's N.Y. Business (Jan. 10, 2009), http://www.crainsnewyork.com/article/20090111/FREE/301119975/rss22.
[18] John Leland, *Swindlers Find Growing Market in Foreclosures*, N.Y. Times, at A1 (Jan. 15, 2009).
[19] Renae Merle, *Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say*, Washington Post at A01 (Dec. 26, 2008).
[20] John Rebchook, Loan modification firms causing more problems for homeowners, Rocky Mountain News (Dec. 24, 2008), http://www.rockymountainnews.com/news/2008/dec/24/loan-modification-firms-causing-more-problems/

- Watsonville, CA – The Mendez family responded to a Spanish radio ad from Saving California, a company that promised to lower the Mendez' mortgage payment. Two months after paying $3,500 to the company their bank had not been contacted regarding a loan modification for the Mendez family.[21]

C. The Danger of Advance Payments Outweighs Any Benefit to Consumers or Competition

Consumers are far more likely to be injured by MARS seeking up-front payments than they are to benefit from them. Any slight benefit is overwhelmed by the number of complaints. Better Business Bureaus have received hundreds of complaints from around the country;[22] the California State Bar reported an average of 900 complaints per month against attorneys alone;[23] and the FTC itself has taken numerous enforcement actions against MARS.[24] A March 2009 survey showed 61% of California housing counselors reported it to be "very common" for homeowners to have a bad outcome with for-profit loan modification services.[25] The fact that some consumers may have been satisfied with a few individual MARS is not a sufficient benefit that would outweigh the harm caused by advance payments in the industry as a whole.[26] Too often, MARS only leave homeowners further in distress and provide nothing of value in return for substantial advance payments.[27]

Prohibiting advance payment also provides the correct incentives for competition. The entity offering loan modification services is in a much better position to judge who it can help than the homeowner is to judge whether the MARS can obtain an affordable modification. The entity offering the modification is familiar with its general success rate and its success with homeowners in similar circumstances. If the entity thinks the chance of obtaining a modification is low, it can simply tell the homeowner it cannot help.[28] The MARS also will be able to determine the consumer's ability to pay because a legitimate MARS would examine the

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[21] Anna Werner, *Loan Modification Firms May Not Always Be Helpful*, CBS5 (Jan. 30, 2009), http://cbs5.com/local/foreclosures.loan.modification.2.922003.html.

[22] Better Business Bureau, *Mortgage Foreclosure Scams on the Rise, Warns BBB: Foreclosure "Rescue" Companies May Promise to Save Your Home, but Only Empty Your Wallet* (Aug. 17, 2007), www.bbb.org/us/article/968.

[23] Testimony of Scott J. Drexel, Chief Trial Counsel, State Bar of California, Before the Subcommittee on Housing and Community Opportunity of the committee on Financial Services of the United States Senate Regarding Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud at 2-3 (May 6, 2009).

[24] Prepared Statement of the Federal Trade Comm'n on Foreclosure Rescue and Loan Modification Scams before the House Comm. on Financial Services Subcomm. on Housing and Community Opportunity at 5-7 (May 6, 2009).

[25] California Reinvestment Coalition, *The Ongoing Chasm Between Words & Deeds V: Abusive Practices Continue to Harm Families & Communities in California* at 8, 23 (survey of non-profit housing counselors and legal services attorneys serving 14,796 consumers in Mar. 2009).

[26] *See Federal Trade Comm'n v. Crescent Publishing Group, Inc.* 129 F. Supp. 2d 311 (S.D.N.Y. 2001) (finding satisfaction of some customers not a benefit outweighing harm caused by deceptive billing and enrollment practices).

[27] *See Orkin Exterminating Co. v. Federal Trade Comm'n*, 849 F.2d 1354 (11th Cir. 1988) (unauthorized fee increase without increase in level or quality of service meets standard for unfairness).

[28] This is generally a better option for a homeowner than the entity failing to modify a loan and then returning all the money. The delay involved in the unsuccessful attempt is often fatal to a homeowner's chances of keeping the home.

consumer's finances before deciding whether the consumer can afford to keep their home and whether a modification is feasible.

Homeowners have no way to evaluate whether a MARS is likely to succeed in obtaining an appropriate modification, and have extremely limited ability to recover money in the case of non-performance. The company will have superior legal resources, or, alternatively may close shop and open up under a different corporate name. Advance fees, instead of benefiting competition, produce counter-productive incentives. Prohibiting advance fees would encourage a MARS that can obtain good loan modifications and discourage entities that cannot.

Finally, in measuring the benefit to competition, the Commission should consider both the emergency nature of the rulemaking and the temporary nature of the MARS industry. Congress recognized the emergency nature of the problem and has required swift action by the FTC. A strict 90 day limit has been placed on the FTC and it has been given a grant of APA rulemaking with respect to mortgage loans, while such APA rulemaking is not generally available to the FTC. The clear message is that this is an immediate, emergency situation requiring not only immediate, but also decisive action. An extraordinary home foreclosure crisis coupled with extraordinarily unresponsive mortgage loan servicers has resulted in a short term but very lucrative opportunity for deception and unfairness by companies promising mortgage modifications. This is not an area where excessive regulation might limit experimentation and innovation in a long-standing industry. This industry will soon cease to exist when these unusual conditions change. There is more need to protect vulnerable consumers from scam operators than there is to foster growth and innovation in this particular opportunistic and short-lived industry.

D. Consumers Cannot Reasonably Avoid The Injury Caused By These Practices

Foreclosure modification offers prey on particularly vulnerable consumers. Homeowners facing foreclosure are in an extraordinarily stressful and confusing situation. They are about to lose their home; their servicer won't answer the phone, loses their documents, and drags its feet; and the newspapers are filled with articles about government programs that the homeowner cannot seem to access or understand.

In this situation, feeling like they have no other option, homeowners are often willing to grasp at straws. A loan modification, however, can be a complex transaction. Affordability and eligibility may be based on a net present value analysis, debt to income ratios, and residual income analysis. The qualification guidelines for many modification programs are confusing to the average consumer and necessary data or guidelines may be unavailable to the public. While the HAMP guidelines are public, crucial aspects of the NPV analysis vary by servicer and are not public. Disclosures will not enable homeowners to make informed choices.

E. Restricting Advance Payments Is a Successful Technique Used to Prevent Unfair and Deceptive Practices in Particularly Abusive Situations

The FTC and Congress have previously used restrictions on advance payment as an effective tactic to prevent unfair and deceptive practices in particularly abusive situations. The FTC Telemarketing Rule prohibits advance payment in three different telemarketing situations:

credit repair, offers to recover money taken through telemarketing fraud, and loan brokering. In all three situations, which are similar to the present one, the FTC found advance fees to be unfair. The Credit Repair Organizations Act, 15 U.S.C. § 1679, *et seq.*, also prohibits advance payment in any credit repair context, even one not covered by the Telemarketing Rule.

These three types of sales share characteristics with mortgage modification offers. They all have a low rate of success, they all involve widespread instances of deception and unfairness, and they all prey on vulnerable consumers. In many ways, mortgage modification offers are the most extreme example. While consumers may feel desperate to clean up their credit record, obtain a loan, or recover lost monies, they are even more desperate not to be thrown out of their home. Repairing one's credit, obtaining a loan, and recovering lost monies may be confusing, but the foreclosure and loan modification processes are much more complex.

While the case is strongest concerning offers of mortgage modification, the rationale in all five contexts (the three FTC Rule provisions, CROA, and mortgage modification) are the same. First, in today's consumer marketplace, when a seller offers to perform a service, and takes the consumer's payment up front, there is an assumption the service will be provided. Common law warranties assume it will be done in a merchantable manner. If the service is not performed, there is an expectation that the payment will be promptly refunded. Where an industry offers its services with a low expectation of success and without refunding money on failure to offer the service, widespread consumer deception is the result. To prevent this deception, the FTC and Congress have required that payment only be made after the service is actually delivered. In fact, the very practice of requiring non-refundable payment where the consumer is unlikely to receive any benefits is an unfair and deceptive practice.

F. Requiring Refunds Is Not Enough to Protect Homeowners

A rule requiring MARS to refund advance payments if they cannot provide the promised service will not be enough to protect homeowners. By the time any refund is made, the consumer will have already sustained serious injury from a MARS that does nothing, delaying the pursuit of other options and letting the foreclosure proceed. Such an injury is as serious—if not more—than losing the fee itself. Imposing a refund requirement instead of an advance-fee ban will do nothing to reduce the risk of MARS making exaggerated promises to obtain the fee even if the fee later must be refunded.

Moreover, requiring refunds instead of banning advance fees poses the obvious risk that the homeowners' money may simply disappear. If a MARS is truly a scam, the fraudster's theft is complete when he obtains payment, so a refund requirement would abjectly fail to protect his victims. Indeed, some MARS are operated by the same people who caused the mortgage crisis in the first place.[29]

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[29] See Alyssa Katz, Predatory Lending With a Smiley Face (Mar. 3, 2004) (describing mortgage and real estate broker involvement in loan modification industry), http://www.salon.com/news/feature/2009/03/04/loan_modifications/. Other loan modification entities have connections to the defunct subprime mortgage industry. For example, USMAC, which charges clients a non-refundable fee of $3,495 to negotiate a loan modification, is owned, in part, by the president of Citywide Mortgage, a former subprime lender. Robert Berner, 'Help' Can Be Costly, Business Week (Nov. 11, 2008).

Mortgage brokers—often cited as one of the driving forces in the growth of bad subprime loans—are in demand to work for loan modification companies.[30] One MARS advertised for consultants with mortgage and real estate experience to join its cadre of loan modification specialists.[31] Its classified ad urged consultants to "Tap Into The Lucrative Loan Modification Industry" and suggested consultants could earn up to $100,000 or more counseling troubled homeowners. The ad notes that "Only strong CLOSERS NEED APPLY!"

Another internet ad says, "LAW FIRM SEEKS STRONG CLOSERS FOR LOAN MODIFICATIONS. Each seat is worth GOLD!!!!! … A realistic earning potential in the 200's in today's market." Among the skills and qualifications sought: "Few months Modification experience is preferred or 'Mortgage Refinance' heavy hitter in the past … No Real Estate License Required …. **The ability to Sell (This is a sales role)**" (emphasis added).[32]

More fundamentally, all for-profit MARS have an inherent conflict of interest when they charge advance fees. Unlike a non-profit HUD-approved counseling agency, a for-profit MARS has an incentive to push the homeowner into taking the first modification offered even if it offers little chance of actually saving the home. As with all businesses, for-profit MARS increase profits to the extent they can reduce expenses. While it is often in a homeowner's best interest to spend extra time negotiating for a better modification offer, it is in the MARS' best interest to give the homeowner as little time as possible.[33] Prohibiting a MARS from collecting any fee until it has provided an affordable, sustainable loan modification for the homeowner, in conjunction with a requirement that fees be commensurate with the benefit to the homeowner, will re-align the MARS's interests with the homeowner's best interests.

G. No Fee Should Be Allowed Unless the Homeowner Obtains an Affordable, Sustainable Modification

Fees should be permitted for loan modification firms only if their services first produce sustainable, affordable loan modifications. Research has proven that the loan modifications many servicers offer do little to make loans more affordable and that poorly designed modifications often end in re-default, harming both the borrower and mortgage holder.[34] Charging a borrower for arranging an unaffordable modification is unfair because the

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[30] *See* Alyssa Katz, *Predatory Lending With a Smiley Face* (Mar. 3, 2004), http://www.salon.com/news/feature/2009/03/04/loan_modifications/ (describing the Loan Processing Center which recruits mortgage brokers from across the country to join the operation).

[31] *See* National Foreclosure Prevention Center, available at http://www.ceasemyforeclosure.com/affiliates.php.

[32] *See* http://www.postjobfree.com/Job.aspx?id=7d2c6c681abd416a9dad4e66400ddea9

[33] In contrast, non-profit housing counseling agencies and Legal Aid organizations do not have a profit motive and private attorneys' profit motive is counter-balanced with strictly enforced rules of professional responsibility that require the attorney to serve a client's best interest.

[34] Even though the OCC has found re-default rates to be highest for modifications that increase the monthly payment or leaves the payment unchanged, servicers reported making this type of modification 54.6% of the time between January 2008 and March 2009. OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data, 1st Quarter 2009, 24 and 31 (6/30/09), http://www.occ.gov/ftp/release/2009-77a.pdf. *See also* White, Alan M., *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications* (Jan. 9, 2009) Connecticut Law Rev. (forthcoming), http://ssrn.com/abstract=1325534.

modification is worthless. It wastes the borrower's limited funds and costs valuable time as the foreclosure deadline approaches. For-profit entities should only be allowed to charge for their services if they succeed in helping the borrower obtain an affordable, sustainable loan modification.

An affordable, sustainable modification may be defined as one that, at a *minimum*, meets the affordability guidelines established by the FDIC's "Mod in a Box"[35] or the Treasury Department's Home Affordable Modification Program (HAMP).[36] A modification may still be considered affordable and sustainable under this definition even if it nets the investor less than it would net in foreclosure.

Although some might say any loan modification is a benefit, this is not true. Consumers are attracted to these entities because they cannot make their existing monthly payments. MARS represent that they will help the consumer by negotiating with the mortgage servicer to make the loan more affordable and thereby save their home from foreclosure. Obtaining an unaffordable modification is not a genuine benefit because the consumer remains unable to afford the payments and foreclosure remains probable. Instead the consumer is merely exchanging one unaffordable payment arrangement for another. Poorly designed and ill-planned modifications will inevitably cause the homeowner to re-default.

An unaffordable modification may also endanger the consumer's chance of negotiating a legitimate, affordable modification because servicers may not be willing to offer another chance. Homeowners already in foreclosure may not have time to negotiate a second, more affordable modification after being unable to afford a modification obtained by a for-profit entity that lacked the skills or perseverance to insist on a successful modification.

IV. A Thirty-Day Cooling Off Period and a Requirement for a Written Contract

The FTC should give homeowners a right to cancel any contract for MARS services similar to the right described in H.R. 1231, the Foreclosure Rescue Fraud Act of 2009. The deadline for canceling, however, should be thirty days, rather than three, given that it may take time for a homeowner to discover that the MARS is not providing anything of value. Additionally, a homeowner that reaches the top of a waiting list for free assistance from a HUD-approved counseling agency should be able to withdraw any authorization she may have given the MARS and switch to the more qualified HUD-approved agency without a financial penalty or other contractual liability.

The right to cancel itself is important because homeowners often seek assistance from for-profit MARS when they are desperate and without knowing they can obtain free assistance from HUD-approved counseling agencies. Vulnerable homeowners are also susceptible to inflated promises and high-pressure sales tactics. Like consumers protected by the Home Solicitation Sales Act, the Credit Repair Organizations Act, and the Truth in Lending Act,

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[35] http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html

[36] http://makinghomeaffordable.gov/. The guidelines for this program are available at http://hmpadmin.com.

homeowners contracting with a MARS need time to reconsider their decision free from aggressive sales tactics and after consulting with a friend, attorney, or housing counselor. As under those Acts, the time to cancel should not begin to run until and unless the homeowner receives notice of the right to cancel and a contract which fully comply with the rules.

Given the vulnerability and desperation of most homeowners seeking loan modification assistance, no amount of disclosure can substitute for a clear ban on advance fees and other unfair and deceptive conduct. To help homeowners seek redress, however, MARS should provide clients with a written contract that clearly describes the specific services to be provided, the homeowner's right to cancel, notice of the ban on advance fees, any other requirements of the rule, and a telephone number for the FTC and the local attorney general.

V. Prohibit Excessive and Unreasonable Fees

The MARS rule should prohibit charging unreasonable and excessive fees for minimal or no service. Fees for loan modification services should be commensurate with the benefit to the homeowner. Loan modification and foreclosure rescue scammers make big promises and charge thousands of dollars but often deliver little. Homeowners go to them for one reason—to save their homes from foreclosure. Any fee charged should bear a reasonable relationship to the benefit actually provided to the homeowner.

The Illinois Mortgage Rescue Fraud Act[37] is a good model for limiting compensation to a reasonable amount: for modifications that reduce the monthly payments on a loan for at least 5 years, the fee is capped at the lesser of the existing principal and interest payment or the total net savings from the lowered payments over the succeeding 12 months. For all other transactions, the maximum fee cannot exceed 50% of the homeowner's existing monthly payment.[38] This approach has two benefits. First, it ensures that no fees are charged unless the homeowner actually receives a benefit commensurate with the fee. Second, it is flexible, avoiding a fee cap that could be inappropriate for the circumstances.

VI. Exemptions Must Be Very Limited

There will inevitably be entities and individuals that argue they should be exempt from any MARS rules. Real estate brokers, attorneys, mortgage brokers, mortgage lenders, and other financial service providers are likely to argue that others should be regulated, but that they should not.

Instead, **nobody** should receive a blanket exemption, and only attorneys should receive a narrow exemption from the ban on advance fees. Entities and individuals such as these have been involved in credit repair scams, foreclosure rescue scams, and property-flipping scams,

[37] 765 ILCS 940/1 *et seq.*
[38] 765 ILCS 940/70.

either openly or as fronts for unlicensed actors.[39] The notion that a mortgage broker's license—or an attorney's license, real estate agent's license, or any other license—ensures that the licensee will not cheat people is palpably false.

A. Mortgage Brokers, Real Estate Agents, and Financial Service Providers

Prohibiting advance fees will not impede the legitimate work of mortgage or real estate brokers because they are normally paid only when a sale or mortgage transaction is completed. But, if real estate or mortgage brokers try to capitalize on the foreclosure crisis by expanding beyond their traditional businesses (of finding mortgages or selling homes) into loan modification or foreclosure rescue efforts, they should be covered by the same rules as other MARS. It is important to note that any cross-reference to a statutory licensing scheme should be examined carefully. Exemptions that incorporate state mortgage or real estate broker licenses by reference may have a much broader scope than originally intended. Some mortgage and real estate broker licensing laws are written broadly and may cover those who offer "services" beyond their traditional roles of finding mortgages or selling homes.

Overall, if the FTC decides that licensed entities need an exemption from some aspects of the rules, it should not exempt anyone but attorneys from an advance fee ban or a requirement that fees be tied to results. Any exemption for attorneys should be subject to the limitations discussed below.

B. Attorneys

The role of attorneys is complicated. Attorneys can play many roles in helping a client avoid foreclosure, not only limited to filing a bankruptcy petition or filing a suit challenging a predatory loan or a defense to foreclosure. Many legitimate legal activities do not involve litigation, such as advising a client of potential claims or defenses, giving advice about the intricacies of loan modification programs, or negotiating a settlement with a lender outside of litigation. Though some attorneys have unquestionably been involved in harmful conduct, an attorney's more beneficial and traditional role of analyzing a client's paperwork and advising the client of potential claims and options may also fit within the definition of mortgage assistance and relief services. Services provided by an attorney take time, cannot always be offered for free, and cannot guarantee success. Thus, drawing a clear line that excludes harmful conduct but does not prevent beneficial legal advice and activities is not so easy.

Attorneys are also regulated at the state level, and misconduct can lead to revocation of their licenses, a severe sanction that does have a deterrent effect. In many states, attorneys also are required to carry malpractice insurance and may be more reachable than other scammers when things go wrong.

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[39] *See, e.g.*, Fed. Trade Comm'n v. Gilkl, 265 F.3d 944 (9th Cir. 2001) (attorney allowed credit repair operator to work out of his office); Vaughn v. Consumer Home Mortg., Inc., 2003 WL 21241669 (E.D.N.Y. Mar. 23, 2003) (denying motion to dismiss by attorneys involved in property flipping scheme); Hoffman v. Stamper, 867 A.2d 276 (Md. 2005) (loan officer and appraiser were involved in property flipping scam); Press Release, *Brown Sues Foreclosure Consultant and Attorney Who Conned Homeowners into Paying Thousands for Phony Lawsuits*, Cal. Attorney General (July 6, 2009), http://ag.ca.gov/newsalerts/release.php?id=1763.

On the other hand, a broad exemption for attorneys could further encourage scammers to use the guise of an attorney license to cloak activities by nonlawyers and avoid consumer protections such as advance fee bans. Thus, we recommend that attorney exemptions be narrowly limited to conduct meeting certain standards:

- Attorney exemptions should be limited to work that qualifies as the practice of law and to attorneys in compliance with Rule 5.4 of the American Bar Association's Model Rules of Professional Conduct. Rule 5.4 prohibits attorneys from sharing legal fees or practicing law in a law firm or other business where a nonlawyer controls the attorney's professional judgment.[40] Thus, the exemption would not be available to a firm that has nonlawyer principals, or to work by nonlawyers working in any capacity other than as employees under the direction of an attorney.

- Attorneys should only be entitled to the exception for work in the state where they are licensed, within the scope of that license, and in compliance with local ethical requirements.

- Attorneys should be permitted to charge advance fees only where the fee or retainer is placed in a client trust account until the work requested is performed as agreed, even where state bar rules do not already impose such a requirement.

  Massachusetts, for example, interprets its ban on advance fees to permit retainer agreements. However, this exemption should only apply to attorneys and should be carefully monitored for signs of abuse.

[40] Rule 5.4 Professional Independence of a Lawyer:
(a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:
(1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
(2) a lawyer who purchases the practice of a deceased, disabled, or disappeared lawyer may, pursuant to the provisions of Rule 1.17, pay to the estate or other representative of that lawyer the agreed-upon purchase price;
(3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement; and
(4) a lawyer may share court-awarded legal fees with a nonprofit organization that employed, retained or recommended employment of the lawyer in the matter.
(b) A lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law.
(c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.
(d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:
(1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
(2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility in any form of association other than a corporation ; or
(3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

- Homeowners should be permitted to cancel the retainer agreement at any time and receive a refund of any unearned fees.

- State bars should also do a better job of cracking down on abusive advertising practices by attorneys. This may include prohibiting attorneys from advertising services that hold out the promise of a loan modification.

C. No Blanket Exclusion for "Non-Profits"

Neither a proposed rule nor any accompanying analysis should indicate a blanket exemption for "non-profits." The FTC Act applies to practices by a "corporation," defined as a company organized to carry on business for profit or for the profit of its members. Creation of a non-profit structure does not always exempt a company from coverage under the FTC Act. For example, in *FTC v. Ameri-Debt, Inc.*[41] a debt counselor was found to be covered by the FTC Act even though it was incorporated as non-profit because it failed to provide promised services and participated in an enterprise with a closely related for-profit corporation.

Similarly, where an individual or individuals control a non-profit for their own benefit and treat the entity's assets as their own, then the FTC Act applies.[42] In fact, there is extensive experience of credit repair organizations mis-using the guise of non-profit status to evade the Credit Repair Organizations Act, 15 U.S.C. § 1679 *et seq.*[43]

The FTC should not provide an easy avenue of escape from the rules for unscrupulous entities that merely organize themselves as non-profits while they seek profit for individuals, members, or related companies. The simple solution is to make no mention in the rules of any exemption for non-profits. To the extent that a true non-profit is outside the scope of the rules, it will be exempt, and the rules need not point this out. We know of no other FTC rule that has an explicit exemption for non-profits.

Analysis accompanying a proposed or final rule might want to assure HUD-approved counseling agencies that true non-profits are outside the scope of the rules. These agencies must be bona fide non-profit, IRS 501(c)(3) corporations, which do *not* charge fees to consumers. These entities are almost surely exempt from the FTC Act. But the analysis should not provide a safe-harbor for bogus non-profits seeking to evade the rules and engage in unfair or deceptive practices.

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[41] 343 F. Supp. 2d 451 (D. Md. 2004) (FTC Act applies to corporations "organized for profit, regardless of the form of their charter or statutory source")

[42] See Ohio Christian College, 80 FTC 815 (1972). See also Community Blood Bank, Inc. v. FTC, 405 F.d2d 1011 (8th Cir. 1969).

[43] *See* Written Testimony of Joanne S. Faulkner Before the Senate Comm. on Commerce, Science, and Transportation Subcommittee on Consumer Affairs, Insurance and Auto Safety Regarding "The Credit Repair Organizations Act: How Can It Be Improved" at 13 (July 31, 2007) ("The FTC has sued 'educational' entities that have nonprofit status but are structured so that founders and their family and friends have high-price contracts for goods or services sold to the nonprofit. . . . . The [proposed] change would endorse the thoughtful interpretation limiting the section's exemption to true nonprofits by the First Circuit Court of Appeals in *Zimmerman v. Cambridge Credit Counseling Corp*., 409 F.3d 473 (1st Cir. 2005).").

VII. Provide a Floor to Protect All Homeowners, But Not a Ceiling

This rulemaking process offers the potential for the FTC to dramatically improve homeowner protections, as long as it does not preempt stronger state laws or regulations. A number of states have already implemented strong, effective laws and regulations regarding this industry and other states may do so in the future. The FTC should issue new rules to protect homeowners in states that have enacted no or only weak protections. The FTC should make clear that federal regulations do not preempt stronger state laws or rules. It is essential that states have the flexibility to respond quickly and creatively to new forms of loan modification scams.

Respectfully Submitted,

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