Comments of the
National Consumer Law Center
(on behalf of its low-income clients),
National Association of Consumer Advocates, National Association of Consumer Bankruptcy Attorneys, Center for Responsible Lending, Consumer Federation of America, Connecticut Fair Housing Center, Jacksonville Area Legal Aid, Inc, Legal Aid of Mansota, Inc., Legal Services of South Central Michigan, Michigan Foreclosure Task Force, Michigan Poverty Law Program, Mid Minnesota Legal Assistance, Neighborhood Economic Development Advocacy Project, and the Virginia Poverty Law Center

Regarding

Federal Trade Commission
FR Doc. 2010-4651, RIN 3084-AB18
16 CFR Part 322

Notice of Proposed Rulemaking
MORTGAGE ASSISTANCE RELIEF SERVICES

Submitted March 29, 2010

These comments are submitted by the National Consumer Law Center (on behalf of its low income clients);[1] the National Association of Consumer Advocates (NACA);[2] NACA members Wesley L. Phillips, Esq. of Phillips Law Group, LLC (Ala.); Charles J. Roedersheimer, Esq. of Thompson & DeVeny Co. LPA (Ohio); Daniel A. Schlanger, Esq. of Schlanger & Schlanger, LLP (N.Y.); Brian W. Steffensen, Esq. of Steffensen Law Office (Utah); the National

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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 Andrew Pizor and many others at 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 manages the Institute for Foreclosure Legal Assistance. The mission of NACA is to promote justice for all consumers. NACA members have been at the forefront of the fight against predatory lending and residential foreclosures.

Association of Consumer Bankruptcy Attorneys;[3] the Center for Responsible Lending;[4] the Connecticut Fair Housing Center; Consumer Federation of America;[5] Jacksonville Area Legal Aid, Inc. (Fl.); Legal Aid of Mansota, Inc. (Fl.); Legal Services of South Central Michigan; Michigan Foreclosure Task Force; Michigan Poverty Law Program; Mid Minnesota Legal Assistance; Neighborhood Economic Development Advocacy Project (N.Y.);[6] and the Virginia Poverty Law Center.[7] These comments are in response to the Federal Trade Commission's Notice of Proposed Rulemaking regarding Mortgage Assistance Relief Services, published on March 9, 2010 in volume 75 of the Federal Register at page 10,707.

I. Summary

We commend the FTC for proposing a strong rule to protect homeowners from unfair and deceptive mortgage assistance relief services. This rule is urgently needed. Standard & Poor's recently estimated that five to seven million more homes may go into foreclosure over the next three years.[8] Meanwhile, until this rule becomes law, scammers will continue to target desperate homeowners with deceptive advertisements and false promises of relief—all for large, up-front payments.[9] The broad scope of the proposed rule with its substantive prohibitions and strong disclosure requirements will significantly reduce some of the most common abuses and will level the playing field for nonprofit services and legitimate attorneys who provide bona fide forms of assistance. Nevertheless, the proposed rule needs improvement to ensure that it can accomplish

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[3] The **National Association of Consumer Bankruptcy Attorneys** (NACBA) is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. Formed in 1992, NACBA now has more than 4,700 members located in all 50 states and Puerto Rico.

[4] The **Center for Responsible Lending** (CRL) is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable mortgages. In total, Self-Help has provided over $5.65 billion of financing to 64,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

[5] **Consumer Federation of America** (CFA) is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy, and education.

[6] The **Neighborhood Economic Development Advocacy Project** (NEDAP) is a resource and advocacy organization, based in New York City. NEDAP employs multiple strategies–including community outreach and education, advocacy, policy research and analysis, and direct legal services–to ensure that communities have access to fair and affordable credit and financial services, and to address inequities in the financial services system. NEDAP chairs the New Yorkers for Responsible Lending coalition, comprised of 147 non-profit groups from around New York State.

[7] The **Virginia Poverty Law Center** (VPLC) provides leadership, support, training, public education, and advocacy to address the civil legal needs of Virginia's low-income population. Through training and communications, VPLC educates others about the legal rights of the poor and identifies systemic problems and issues. VPLC works collaboratively with Virginia's legal aid community, other organizations, and stakeholders to represent the interests of low-income Virginians in the courts, executive agencies, and legislative bodies.

[8] Renae Merle, New round of foreclosures threatens housing market, Washington Post (Mar. 12, 2010) at A01.

[9] 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). For a more detailed discussion of problems with the for-profit MARS industry, see our previous comments in response to the FTC's ANPR on this rulemaking, attached as Exhibit 1 and incorporated by reference.

its stated goal and to avoid unintended negative consequences. Some of the more significant changes required include:

- The rule needs stronger self-enforcement mechanisms including a right to cancel and a provision that will automatically void noncompliant contracts, requiring providers to disgorge any funds obtained in violation of the rule;
- The attorney exemption should be replaced with a broader rule based on criteria that will protect consumers, as the existing proposal will deprive consumers of legitimate, bona fide forms of legal assistance;
- MARS providers should not be paid for any modification unless it is affordable and has an interest rate that does not exceed the HAMP guidelines.

II. The Proposed Rule Will Protect Consumers.

The proposed rule includes a number of good provisions to protect homeowners. The single most important provision is section 322.5, which prohibits the collection of any fee before providing tangible results of real value to consumers. Wrongdoers are attracted to mortgage assistance relief services by the potential for extracting large payments from homeowners without performing any work or providing anything of value. Requiring mortgage assistance relief services (MARS) providers to earn their fee before being paid will rid the market of those who specialize in nothing more than "take the money and run."

The FTC's proposal to prohibit payment for loan modifications unless the modification will last for at least five years is also an important protection but needs some improvements discussed below. MARS providers often claim to specialize in obtaining loan modifications from mortgage servicers. Instead the truth is that MARS providers are unlikely to accomplish any more than a free housing counselor or obtain anything that consumers could not do on their own. We welcome the rule's list of other prohibitions and the mandatory disclosures. These provisions are also important but would be insufficient without section 322.5's payment restrictions.

The broad definition of MARS and MARS provider are also important aspects of the rule that will help ensure its effectiveness. By including all possible forms of mortgage relief assistance, including those represented by implication to assist or attempt to assist consumers, the FTC has reduced the possibility of scammers evading the rule with tricks or loopholes.

We similarly commend the FTC for broadly defining "dwelling" to include mobile homes, trailers, second homes, and rental properties.[10] Mobile homes, trailers, and manufactured houses are still "homes" to the same extent as any site-built home. The fact that some may be subject to repossession rather than foreclosure[11] has no bearing on whether their owners and occupants are entitled to the same protection from scammers. However, we urge the FTC to add the term "manufactured home" in addition to “mobile home.” The term "mobile home" is often used to signify homes that were constructed prior to the adoption of HUD standards in 1974, while the term “manufactured home” means a home built after 1974 in compliance with the HUD

[10] *See* Proposed Rule § 322.2(d) (definition of "dwelling"); 75 Fed. Reg. 10,707, 10,713.
[11] Some states categorize manufactured homes as chattel rather than real estate, meaning they can be repossessed like automobiles rather than through the foreclosure process required for real estate. *See* Manufactured Housing Resource Guide: Titling Homes as Real Property, Nat'l Consumer Law Ctr. (Jan. 2009).

standards. The National Manufactured Housing Construction and Safety Standards Act, 42 U.S.C. § 5402(6) includes a definition of the term “manufactured home.” While most non-site-built homes today are post-1974, there are still millions of occupied pre-1974 homes, so it is important that the rule cover both.

It is important to include second homes and rental properties in the scope of the rule. Some homeowners at risk of foreclosure include senior citizens who may be living in nursing homes or assisted-living facilities or may have moved in with relatives elsewhere. In other instances a home and mortgage may be in the name of a spouse or family member who no longer lives in the household due to a marital dispute or the need to move elsewhere for employment. It is also not unusual for military servicemembers to rent out their permanent homes while being posted elsewhere during their military careers. Similarly, family members sometimes lease family-owned real estate to other family members at below-market rates. All of these homeowners and occupants are as equally deserving of protection from scammers as are consumers who qualify as owner-occupiers. In addition, including second homes and rental properties in the rule will ensure that scammers do not find a "niche market" beyond the scope of the rule.

III. Attorneys Should Be Exempt from the MARS Rule If They Meet Appropriate Requirements.

The proposed attorney exemption is too narrow and risks causing more harm than good. The exemption as written has significant flaws and should be replaced entirely. We readily acknowledge that attorneys have been among those perpetrating abusive MARS activities. However, the record also acknowledges, but in much less detail, that legitimate attorneys offer highly valuable and often unique services that help save homes from foreclosure as well as from the abusive MARS that the rule is designed to combat. The proposed rule will interfere with the ability of legitimate attorneys to help consumers. Unless the FTC changes the exemption, homeowners will lose some of their most skilled allies in fighting mortgage-related problems.

Although we support the FTC's goal of enacting strong MARS regulations, the FTC has drastically underestimated the range of legitimate legal services within the scope of the rule and the number of legitimate attorneys whose representation of homeowners would fall under the proposed definition of “MARS.” The FTC has also erred in concluding that all attorneys should be subject to the same rules as non-attorney MARS providers without regard to how services are actually provided.

In this section of our comments, we set forth the problems with applying the proposed rule to all attorneys and several more specific problems with the proposed exemption. We then describe our recommendation for a more appropriate substitute. We also discuss a potential alternative to both the FTC's proposal and our recommendation.

PROBLEMS:

A. The Proposed MARS Definition Covers a Broad Range of Legitimate Legal Services.

The MARS definition is extremely broad. It includes so many bona fide forms of legal assistance that almost any attorney helping a consumer with a mortgage-related problem could potentially be subject to the rule. Proposed section 322.2(h)(1), for example, defines as a MARS any service "to assist or attempt to assist the consumer with . . . [n]egotiating, obtaining, or arranging a modification of any term of a dwelling loan[.]" That definition would include negotiating a loan modification to settle of any form of pending or anticipated litigation.

Whether the litigation or threatened litigation involves foreclosure, unwinding a sale-leaseback,[12] racial discrimination in violation of the Equal Credit Opportunity Act, or inaccurate disclosures that violate the Truth in Lending Act, the consumer's lawyer would be subject to the proposed rule if he or she sought a loan modification from the mortgage holder during settlement negotiations or if one goal of the litigation was to prevent foreclosure on a predatory loan. Similarly, if a mortgage servicer assessed improper charges to a consumer's account, in violation of the Real Estate Settlement Procedures Act, any lawyer sending a qualified written request to the servicer to dispute the balance could potentially be subject to the proposed rule because the request is represented to assist the consumer in obtaining a modification of the servicer's inaccurate statement of the principal balance and fees. Helping a servicemember exercise her right to obtain an interest rate reduction during her deployment to Afghanistan, pursuant to the Servicemembers Civil Relief Act, would also subject an attorney to the proposed rule.

The phrase "assist or attempt to assist the consumer with . . ." is so broad that it could potentially include merely providing advice to a consumer, explaining the consumer's obligations under the law, or explaining a contract.

Proposed subparagraph (2) is perhaps even broader. It sweeps into the definition any work that assists the consumer with "saving the consumer's dwelling from foreclosure or repossession." This part of the definition would include all foreclosure defense litigation, tempered only by the extremely narrow exception for preparing and filing certain litigation documents. It could potentially subject any bankruptcy attorney to the proposed rule when representing any homeowner who was having difficulty making ends meet because, even if the homeowner/debtor was not in foreclosure at the time he retained the bankruptcy attorney, the rule applies to any service represented to assist consumers in "preventing" foreclosure.

B. More Attorneys Assist Homeowners with Mortgage and Foreclosure Matters Than the Federal Trade Commission Realizes, and the Proposed Rule Would Make This Essential Assistance Less Available.

The Notice of Proposed Rulemaking cited an absence of data regarding the number of attorneys providing MARS and whether an advance fee ban would deter them from helping consumers.[13] In response to this, NCLC surveyed private practice members of the National Association of Consumer Advocates who had previously expressed interest in mortgage issues and all members of the National Association of Consumer Bankruptcy Attorneys.[14] Of 284 attorneys to complete

[12] Frequently the perpetrator of a sale-leaseback scam will mortgage the consumer's property, or sell it, to a bona fide third-party. If the scammer mortgages it, a legitimate attorney may need to negotiate with the mortgage company to save the home from foreclosure when the scammer fails to pay the loan.

[13] 75 Fed. Reg. at 10,725.

[14] The survey was sent to approximately 5,275 e-mail addresses. Attorneys belonging to both NACA and NACBA may have received the survey twice but were instructed to only respond once. The instructions said the survey was only directed to consumer advocates practicing bankruptcy law and any lawyers who help consumers with mortgage, foreclosure, loan modifications, short sales, predatory lending, "or anything vaguely related." Lawyers

the survey, 98% said they engage in activities for a fee that fall within the proposed definition of a MARS, in connection with a court or administrative proceeding or preparing or filing a bankruptcy petition. Thirty-nine percent engage in services within the definition that are not in connection with a court or administrative proceeding or a bankruptcy petition.

Some of these attorneys would cease performing this type of work if the proposed rule is implemented without changes to the attorney exemptions. In anonymous comments submitted with the survey one attorney wrote, regarding services within the MARS definition: "I do not offer these services due to a recent California law that makes it illegal to accept prepayment for such services. Instead I instruct consumers on resources that can assist them, or guide them to information which can assist them." Another wrote:

> My office and staff only perform loan modification and negotiations with mortgage companies in connection and directly related to the bankruptcy services we provide to our clients. Placing additional regulations on how clients compensate bankruptcy attorneys would most likely drive many attorneys out of the bankruptcy business because of the delays in getting paid. Thus, this would result in significantly reduced legal services available to distressed homeowners who need to save their homes through Bankruptcy.

Attorneys are likely to cease representing homeowners because of the risk that clients with unreasonable expectations would not pay. A consumer who receives an unfavorable legal opinion or a bona fide and reasonable loan modification that is not to his liking might simply refuse to pay. At least one attorney has submitted comments to the FTC describing such an experience. Geoffrey Giles, an attorney in Reno, Nevada, worked for eight months to win a loan modification from a non-HAMP participating bank last year, only to have the client refuse to pay for his services: "The reason she is not paying me is because I did not get her a 2% deal like she read about on the internet."[15]

Even though the National Consumer Law Center and the National Association of Consumer Advocates submitted comments to the FTC in response to the Advance Notice of Proposed Rulemaking,[16] a footnote to the NPR incorrectly says "the Commission did not receive any comments in response to its ANPR from attorneys or organizations representing attorneys addressing the role of attorneys in connection with providing loan modification services."[17] The National Consumer Law Center is an advocacy organization rather than a membership organization, but the National Association of Consumer Advocates is a membership organization composed almost entirely of attorneys. A substantial focus of the joint comments was the

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practicing law as part of a non-profit legal services program and government employees were instructed not to take the survey. NACA states that approximately 1/3 of its members describe themselves as "Legal Service/Public Interest," and NACBA describes its membership as "overwhelmingly private practice," so most of the recipients were probably eligible to take the survey.

[15] Letter of Geoffrey L. Giles to Robert Mahini, dated Feb. 10, 2010 at 3 n.4.

[16] 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 (July 15, 2009), attached as Exh. 1 (hereinafter "NCLC ANPR Cmts"); Advance Notice of Proposed Rulemaking: Mortgage Assistance Relief Services, 74 Fed. Reg. 26,130 (June 1, 2009).

[17] 75 Fed. Reg. at 10,723 n.188.

application of any proposed restrictions to attorneys. As these comments and our previous comments[18] wish to make clear, legitimate attorneys play a critical role in providing bona fide and valuable assistance to consumers seeking loan modifications and other forms of mortgage-related assistance. While there may unfortunately be "a growing number of attorneys" engaged in unfair practices,[19] the FTC's record does not support the conclusion that all consumer protection attorneys should be treated as potential scammers.

C. The Federal Trade Commission's Decision to Subject All Attorneys Providing Services Within the MARS Definition To Most of the Proposed Rule Is Flawed.

The FTC has determined that all attorneys providing all services falling within the proposed MARS definition should be subject to the proposed rule, with narrow exceptions. This conclusion is based on flawed reasoning and is an over-generalization. The FTC has extrapolated from the misconduct of a few in one area to find a need to regulate all in a much broader area. Given the significant restrictions the rule will impose on the practice of law, the record does not justify the FTC's conclusion.

The complaints and enforcement actions described in the NPR clearly show a problem with non-attorneys providing mortgage assistance relief services. Although the record also shows a problem with attorney MARS providers, those problems have primarily been with attorneys employed by or in a business relationship with non-attorneys.[20] The most effective way to protect the public from the type of attorney misconduct described in the NPR without deterring legitimate attorneys from helping homeowners is to design an exemption that separates the attorneys who are providing legitimate services from those who are not.

D. There Are Additional, Specific Problems With the Exemption As Drafted.

Section 322.7 of the proposed rule exempts an attorney licensed to practice law in the consumer's state of residence from only two prohibitions: 1) the prohibition against instructing a client not to contact the opposing party, and 2) the prohibition on accepting advance fees for preparing or filing certain documents in connection with a bankruptcy or other court proceeding or an administrative proceeding. Attorneys qualifying for this exemption will remain fully subject to the rest of the proposed MARS rule. Among the most problematic aspects of this structure is that attorneys will remain subject to the disclosure and compliance rules and partially subject to the advance payment rule. This structure, however, is flawed and unworkable.

It is admittedly difficult to design an exemption that will protect consumers from misconduct without deterring the all-too-small number of qualified, legitimate attorneys willing to help consumers who have unaffordable or predatory mortgages. The supplementary information published with the proposed rule stated the FTC’s desire to draft an exemption that would be clear and easy to enforce.[21] However, the practice of law is too complex and too varied to rely on a bright line rule. Rather than implement a rule that throws the good attorneys out with the bad, the FTC must design an exemption that separates the good from the bad based on their business practices.

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[18] NCLC ANPR Cmts at 14-15.
[19] 75 Fed. Reg. at 10,710.
[20] *See* 75 Fed. Reg. at 10,710 (examples of misconduct).
[21] 75 Fed. Reg. at 10,725.

1. The licensing exemption fails to include the state where the dwelling is located.
Proposed subsections 322.7(a) and (b) limit the exemption to attorneys "licensed to practice law in the state in which the consumer resides[.]" The reason is that, as the FTC has noted, "[i]n many cases, [problematic] attorneys have not been licensed to practice law in the states where consumers who purchase the MARS reside."[22]

The FTC's formulation of the licensing requirement, however, overlooks circumstances in which a homeowner would need to retain an attorney in another state. This is most likely to occur with second homes and rental properties.[23] When a mortgage holder or servicer initiates a foreclosure action, the foreclosure process will take place where the dwelling is located and the homeowner will need an attorney licensed in that jurisdiction, even if it is not where the homeowner resides.

2. The litigation exemption is unworkable.
Subsection 322.7(b) of the proposed rule includes a partial exemption from the compensation restrictions in § 322.5, but the exemption is badly flawed and implementation will be impractical. According to subsection 322.7(b), attorneys are exempt from § 322.5 "in connection with preparing or filing: (1) A bankruptcy petition or any other document that must be filed in a bankruptcy proceeding; or (2) Any document that must be filed in connection with a court or administrative proceeding." Close examination of this exemption shows it is overly complex and quite narrow.

The exemption only applies to the act of "preparing or filing" two specific categories of items: "bankruptcy petition[s]" and other "document[s]" (hereinafter "exempt documents"). This means the exemption does not apply to attorneys engaged in a number of common litigation-related activities, such as oral arguments, trials, mediations, planning conferences with judges, taking or defending depositions, or explaining pleadings received from the opposing party during litigation.

In addition, bankruptcy petitions and other documents only qualify as exempt documents if they "must" be filed in a bankruptcy proceeding, a court, or an administrative proceeding. Determining whether a petition or other document "must" be filed will be exceedingly difficult and will not provide the bright-line rule the FTC intended to establish. What are the standards for determining whether any bankruptcy petition must be filed? Must a consumer file a counterclaim to rescind a predatory loan or does the counterclaim not qualify as an exempt document because it is optional? Must an attorney file a motion for summary judgment? A motion in limine? The test is simply unworkable.

[22] 75 Fed. Reg. at 10,724. In contrast, of 277 respondents to NCLC's survey, only three (1.1%) attorneys reported offering MARS to consumers in states where they are not admitted to the bar.
[23] For example, it is not uncommon for a low-income homeowner to move in with an ailing relative in another state in order to care for the relative. The homeowner's adult children may then live in the homeowner's home, or the homeowner may rent it out to third parties.

3. The disclosure and compliance rules are ill-suited for attorneys practicing law. Proposed sections 322.4 and 322.9 include a series of mandatory disclosures and compliance practices. These requirements were obviously not designed for traditional law firms or solo practitioners. Instead they were designed for telemarketers and others engaged in the commercial sales activities commonly seen among non-attorney providers of MARS.

a. Disclosures. There is little evidence that consumers have mistaken law firms for government agencies or nonprofits, and consumers are more likely to be confused than informed by the references to buying "mortgage assistance relief services" and "offer[s]" from a law firm. Even if the disclosures could be re-written in a manner applicable to legitimate law firms, they would remain inappropriate for some important types of legitimate legal work.[24] The disclosures would also pose significant problems for bankruptcy attorneys who are already required to make equivalent disclosures under the Bankruptcy Code but using different terminology. A bankruptcy attorney attempting to comply with both the Code and the proposed MARS rule would need a confusing list of potentially conflicting disclosures.

b. Compliance Rules. The compliance rules are extremely ill-suited and inappropriate for attorneys. The most obvious example is the requirement to record communications with potential and current clients. Not only would this arrangement be prohibitively expensive for most consumer protection attorneys, who tend to work in small practices, but it could be impossible for solo practitioners to comply because the rules clearly contemplate a business structure involving multiple employees and levels of supervision. More importantly, informing clients (especially potential clients) that the attorney is recording their conversations would be ruinous to the attorney-client relationship, would potentially violate the attorney-client privilege, and may violate some state bar regulations. It must be remembered that consumers will call law firms subject to the MARS rule about many different topics, including requests for legal representation that are not subject to the rule. If calls are recorded, it is highly doubtful that anyone would be willing to explain why they were calling the law firm if the request for assistance involved something personal or confidential.

4. The advance payment rule will prohibit attorneys from providing traditional legal services.

As previously discussed in section III.A of these comments, legitimate attorneys have traditionally provided many forms of legal assistance that fall within the proposed definition of a MARS. These services are valuable to clients and often take significant amounts of time and preparation for which law-abiding attorneys deserve to be compensated—even when the service is not intended to produce a specific result or fails to obtain a desired outcome. Providing advice and representing a litigant in court are two of the most obvious examples. The proposed advance payment rule would only allow attorneys to receive payment upon achieving results. In practice, this would prohibit attorneys from requiring advance payment, or receiving any payment, for providing advice or for representing a client in unsuccessful litigation. As a result, there will be fewer attorneys able to represent consumers in matters covered by the MARS rule. Notably, because the rule only affects services to consumers, mortgage companies would still be able to hire lawyers for legal advice and foreclosures, but consumers would not be able to do the same.

[24] For example, none of the disclosures would be appropriate for litigating a Truth in Lending rescission case or unwinding a sale-leaseback transaction.

We understand that this was not the FTC's intention, but the result is a highly unfair rule that could do far more harm than good.

SOLUTIONS:

E. The FTC Should Adopt a Broader Exemption Rule Based on Conduct.

The proposed rule includes attorneys based largely on whether they help consumers with mortgage-related problems. The exemption available to attorneys is only a partial, narrow exemption. We recommend replacing the current proposed exemption with a broader one based on the attorney's conduct. Attorneys helping consumers with mortgage-related problems who do not engage in conduct that has been associated with the problems described in the NPR should be fully exempt from the proposed rule, with the possible exception of the prohibited misrepresentations in section 322.3(b).

Attorneys qualifying for the exemption should be treated differently from non-attorney MARS providers for a number of reasons. First, by meeting the criteria for the exemption, legitimate attorneys will be providing other forms of assurance that they are law-abiding and will provide bona fide services. Second, the FTC's record shows abuses have largely been committed among non-attorneys and attorneys engaged in conduct that would preclude them from receiving the exemption. The examples of attorney misconduct in the NPR are insufficient to outweigh the far longer and broader record of legitimate service provided by attorneys nationwide. Third, the harm the advance fee ban would cause to consumers (by reducing access to legitimate consumer protection attorneys) would outweigh the harm of giving those same attorneys a carefully tailored exemption to the MARS rule.

For these reasons, we urge the FTC to craft a broader exemption for attorneys that is based on conduct. Under our proposal, attorneys providing bona fide legal representation would not fall within the MARS definition as long as they met the criteria listed below.

1. The attorney must be licensed to practice law and in good standing in the jurisdiction where the consumer resides or the dwelling at issue is located.

The first criterion we recommend is that, to qualify for the exemption, the attorney must be licensed to practice law in the jurisdiction where the consumer resides or the dwelling is located, in good standing in that jurisdiction, and in compliance with all bar regulations and rules of professional responsibility.[25] This requirement is similar to one of the factors included in the FTC's current proposal for treatment of attorneys, but extends it to attorneys who are licensed where the dwelling at issue is located. This requirement alone will greatly reduce MARS abuses by attorneys, which, as the FTC notes, have often involved offering services in states where the attorney is not licensed.[26] Allowing attorneys to charge advance fees only for work in jurisdictions where they are licensed will mean that attorneys will not be able to act as fronts for multi-state MARS operations. The smaller, less populous states are not likely to have a large enough pool of potential victims to make an attorney-run, in-state operation profitable. For these reasons, we submit that the MARS rule should be inapplicable in its entirety to attorneys who are

[25] This should include attorneys personally authorized by a judge to participate in a specific case pending in a jurisdiction where the attorney is not licensed, such as admission *pro hac vice*.

[26] 75 Fed. Reg. at 10,724.

licensed in the jurisdiction where the consumer lives or the property is located *and* meet the other requirements that we are recommending in these comments.

2. The attorney must personally provide the legal service while acting in the ordinary practice of law.

The FTC also found that problematic attorneys "purporting to provide MARS often play little or no role in counseling or negotiating on behalf of borrowers [and] they may violate state bar requirements that they provide bona fide legal services to their clients." Therefore, requiring attorneys to personally provide legal services to a consumer as a condition of being exempt will avoid abuse of the exemption. This requirement should not preclude working *with* traditional legal support staff, such as qualified paralegals, legal assistants, and student law clerks, but it will make attorneys fully subject to the MARS rule if they delegate all work to non-attorneys while doing nothing more than rubber-stamping letters or acting as a figurehead for deceptive advertisements.

3. The attorney must put any advance fee accepted in a client trust account until earned pursuant to the terms of a written agreement that details the work to be performed by the attorney and the fee schedule for the attorney's work.

Requiring attorneys to place advance fees in client trust accounts[27] is a suitable condition for exempting attorneys from the MARS rule, particularly the rule against advance fees.[28] Attorneys in many states have long been required to escrow unearned fees, and client trust accounts are recognized as an appropriate method of protecting money that remains the property of the client until earned by the attorney. Seventy-two percent of attorneys responding to NCLC's survey indicated that their jurisdiction requires this practice. Client trust accounts are also well regulated and many state bars have adopted dispute resolution procedures for resolving disagreements over whether an attorney has earned a fee.[29] Fees awarded pursuant to a court order would not need to be placed into a trust account because the court's scrutiny in making the order would carry with it sufficient protection from abuse.

In the NPR the FTC expressed concern that "MARS providers might improperly obtain access to MARS funds in escrow accounts" and cited the case of *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX) as an example.[30] In that case, an attorney "improperly transferred 90% of funds from client trust accounts associated with loan modification services to other non-attorney business partners."[31] The attorney in that case, however, would not have been eligible for exemption from the advance fee ban (or any other part of the rule) under our proposal,

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[27] State law sometimes imposes different requirements on different types of "escrow" accounts depending on the context. For clarity, we will refer to the accounts maintained by attorneys for the safe keeping of client funds (including unearned fees) as "client trust accounts."

[28] Another suggestion that has been raised is requiring attorneys to document the work they have performed as a condition for exemption. While this concept has potential, it would, however, need to be refined in order to be properly evaluated. If the FTC is interested in further developing this idea, we encourage doing so in consultation with state bar agencies and groups representing attorneys, before implementing a final rule.

[29] *See, e.g.*, Handbook on Client Trust Accounting for California Attorneys, State Bar of California (2006); District of Columbia Bar Attorney Client Arbitration Board, *available at* www.dcbar.org/inside_the_bar/departments/attorney_client_arbitration_board/about.cfm

[30] 75 Fed. Reg. at 10,721.

[31] 75 Fed. Reg. at 10,721 n.164.

because he had non-attorney business partners and was sharing fees with them. Nevertheless, even if he had been eligible for the exemption, there will always be violations of the rules regardless of how strict they are. A client who is injured by an attorney removing funds from a trust account will have recourse to the jurisdiction's attorney discipline system, many of which include client recovery funds to provide redress in exactly this situation. A consumer injured by a non-attorney, however, must contact the local police, attorney general, department of consumer affairs, or the FTC—many of which are unlikely to have sufficient resources to respond to individual complaints and will not have as much experience with this type of problem as do state offices that are devoted to regulating attorneys.

4. The attorney must be engaged in the practice of law through the same business entity ordinarily used by the attorney when providing legal services that are not within the scope of the rule;

5. Notwithstanding the above requirements, an attorney providing legal services that are within the FTC's MARS definition shall not be exempt from the MARS rule if the attorney shares any fee from providing the service with a non-attorney or if the attorney engages in or benefits from a MARS through a partnership, corporation, association, referral arrangement, or other entity or arrangement:[32]

(i) that is directed or controlled, in whole or in part, by a non-attorney; or
(ii) in which a non-attorney holds any interest; or
(iii) in which a non-attorney is a director or officer thereof or occupies a position of similar responsibility; or
(iv) in which a non-attorney has the right to direct, control or regulate the professional judgment of the attorney; or
(v) in which a non-attorney who is not under the supervision and control of the attorney delivers the service or exercises professional judgment with respect to the provision of the service.

The last two requirements (paragraphs (4) and (5)) are different methods of approaching the same problem—attorneys who are primarily engaged in the commercial business of providing a limited number of MARS (usually loan modification assistance) rather than the bona fide practice of law. Attorneys engaged in this form of business are more comparable to the non-attorney owner or manager of a business than a lawyer engaged in the practice of law. It is these businesses that most often use their affiliation with an attorney to mislead consumers about the type of service they will receive and who will perform the service.

Requirement (5) is based on Rule 5.4 of the American Bar Association's Model Rules of Professional Responsibility. Under this rule attorneys are forbidden from sharing fees or control

[32] This is not intended to restrict referrals through legitimate bar associations, Private Attorney Involvement programs operated by Legal Services Corporation funded organizations (under 45 C.F.R. § 1614) and similar programs, bona fide pro bono panels, or legitimate prepaid legal services plans such as those operated for union members that have non-attorneys on their boards.

of a law practice with a non-attorney.[33] This rule is designed to preserve the attorney's professional independence of judgment and independence in how the attorney renders legal services to his client.[34]

F. The FTC Should Consider Allowing States to Opt-Out of the Attorney Provisions to Provide an Alternative Methods of Regulating Attorney Conduct.

We encourage the FTC to consider allowing states to opt-out of the MARS rule to the extent that it affects attorneys. This alternative would recognize that proper regulation of attorney activities requires knowledge of local practices, and would enable states to make appropriate adjustments to ensure that consumers continue to have access to law-abiding consumer protection attorneys.

Under this alternative, the FTC would use a method similar to the one devised by Congress to implement the SAFE ACT of 2008.[35] The SAFE Act requires states to implement a system for the regulation and licensing of loan originators but also specifies that the Department of Housing and Urban Development will impose its own set of rules on any state that fails to comply. The FTC could use a similar method by allowing states to opt-out of the proposed MARS rule, to the extent that it covers attorneys, if the state implements its own rules. The FTC could incorporate the state rules into its own rule, so that they would be subject to the same enforcement provisions as proposed in the FTC's MARS rule, including federal and local enforcement.[36]

IV. Additional Recommendations and Comments.

A. The Rule Should Include a Right to Cancel.

The Commission's notice of proposed rulemaking specifically sought comment on whether the proposed rule should include a right of rescission.[37] We strongly urge the FTC to give homeowners the right to cancel any MARS contract. The lack of such a right is a serious flaw in the proposed rule. The advance fee ban is not sufficient to protect consumers because a consumer entering into a MARS contract will be legally bound to it--even if the consumer later realizes the service is not desirable, not needed, unreasonably priced, has onerous terms, or violates the rule. As the FTC itself stated in the notice of proposed rulemaking:

> In light of the acute financial and emotional distress faced by consumers of MARS, consumers often may not have or take the time needed, or obtain the information necessary, to consider carefully their options before deciding to purchase these services. A right of rescission would serve to provide consumers with additional time to make decisions.[38]

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[33] "California is the only state[ ] that do[es] not have professional conduct rules that follow the format of the ABA Model Rules of Professional Conduct." American Bar Association, Center for Professional Responsibility, www.abanet.org/cpr/mrpc/model_rules.html.
[34] ABA Model Rules of Prof'l Conduct, Rule 5.4 – Cmt. ¶ 1-2.
[35] Secure and Fair Enforcement for Mortgage Licensing Act of 2008, Pub. L. No. 110-289, §§ 1501-1517 (codified at 12 U.S.C. §§ 5101-5116).
[36] *See* Proposed Rule § 322.10.
[37] 75 Fed. Reg. at 10,721
[38] 75 Fed. Reg. at 10,721 (footnotes omitted).

Additionally, a homeowner who 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.

There is extensive precedent for giving consumers the right to rescind contracts when the consumer is at risk of making a rash decision due to emotional or financial distress or aggressive sales tactics.[39] The right to rescind has been proven effective in protecting consumers. Homeowners contracting for a MARS need time to reconsider their decision free from aggressive sales tactics and after consulting with a friend, attorney, or housing counselor.

The minimum right to cancel for any reason and without contractual liability should be thirty calendar days. A cancellation period longer than the three-day period common in other rules is appropriate due to the inherent difficulty of determining whether the provider is providing anything of value and due to the history of deception in some MARS activities, especially those involving title transfers. In a home improvement contract or a mortgage loan transaction, the homeowner can easily see tangible evidence that the other party is performing the contract (by initiating construction or disbursing funds). In contrast, "phantom help" is one of the most significant problems with MARS providers. A consumer receives nothing of value when the MARS provider does nothing more than send a form letter or leave a message for the mortgage servicer. The consumer needs sufficient time to discern whether the provider is performing the contract in good faith.

Consumers should also have an right to cancel the MARS contract upon obtaining the services of a HUD-approved counseling agency, subject only to payment for bona fide and reasonable actual expenses or services fully completed for which the MARS provider would otherwise be entitled to payment under the proposed rules. Actual expenses should be strictly limited to the actual amount of funds disbursed to third parties, such as postage, as documented by receipts provided by the third party.

As with other rules and statutes establishing a right to cancel, the time to cancel should not begin to run until and unless the homeowner receives written notice of the right to cancel and a contract which fully complies with the rule.

B. The Rule Should Automatically Void Contracts Violating the Rule.

As previously described, the proposed rule includes a number of important disclosure requirements and prohibitions. The rule, however, lacks two vital provisions for ensuring compliance: 1) any contract made in violation of the rule should be automatically void, and 2) service providers should be required to disgorge any funds received in violation of the advance

[39] The Commission has previously issued regulations providing for a rescission period in circumstances in which the context of the transaction made it difficult for consumers to make well-informed purchasing decisions. *See* Door-to-Door Sales Rule, 16 CFR 429.1, *et seq.*; Trade Regulation Rules: Mail or Telephone Order Merchandise (Mail Order Rule), 16 CFR 435.1(c) (1993); *see also* Door-to-Door Sales Rule Statement of Basis and Purpose, 37 Fed. Reg. 22,943, 22,937. There are also several federal laws that grant a right to cancel, such as the Home Solicitation Sales Act, the Credit Repair Organizations Act, and the Truth in Lending Act.

payment rule or other rule. Including these requirements will protect homeowners who need to enforce these rules without the assistance of an attorney or a state official.

C. Independent, Third-Party Escrow Accounts Will Not Protect Consumers.

The FTC has requested comment on whether it would be appropriate to allow MARS providers to put advance fees into escrow accounts controlled by a third-party instead of banning all advance fees. The change, however, would weaken the rule and is not advisable. One reason the advance fee ban is appropriate for those not qualifying for the attorney exemption is the weight of evidence showing frequent misrepresentations in soliciting MARS business. The MARS industry is characterized by false promises of the potential for success and companies alleging special experience or knowledge about loan modifications. These promises are used to convince consumers to make payments before any work has been performed.

Statistical data showing the difficulty in obtaining a permanent modification also weighs against allowing this type of escrow account because requiring consumers to pay anything up-front (even if into escrow) is based on the assumption that the consumer will receive something of benefit in return. Mortgage servicers are hardly modifying any loans on the long term basis necessary to save homes from foreclosure. Fewer than ten percent of eligible borrowers receive permanent modifications while the rest are offered nothing more than temporary modifications and are not being converted to permanent modifications.[40] Meanwhile monthly foreclosures are dramatically outpacing even temporary modifications.[41] The Treasury Department's latest HAMP data show few homeowners are receiving permanent modifications[42] so there is little justification for MARS providers to charge any fee until they have delivered results. Even if the money is placed in an escrow account, consumers have still been injured by losing the use of their funds and will need to fight for a refund when the MARS provider fails to deliver as promised.

Escrow accounts controlled by third-parties also raises other concerns. The third-party will inevitably charge for its services, which will increase the price of already dubious MARS. There will also be the risk of MARS providers making agreements with the escrow manager for referral fees or kickbacks. Disputes will inevitably arise between the MARS provider and the consumer over whether the money should be returned when a consumer demands a refund, or whether the provider has done enough work to earn payment. Given the history of other industries, this will likely result in desperate consumers being further hamstrung with forced arbitration clauses and fees. During this time, the consumer's money will be frozen in the escrow account when the consumer may need it for mortgage or other debt payments, or to pay moving expenses and a security deposit on a new home. We discourage the FTC from adopting this proposal, but if the FTC is inclined to adopt it, the consumer should be expressly authorized to withdraw their money from escrow at anytime for any reason and thereby cancel the MARS contract.

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[40] Corbett B. Daly, Treasury says 1 million homeowners in loan modifications, Reuters (Mar. 12, 2010), *available at* www.washingtonpost.com/wp-dyn/content/article/2010/03/12/AR2010031202339.html.

[41] Alan White, Latest HAMP report: Treasury program a failure, Consumer Law & Policy Blog (Feb. 17, 2010) (Prof. Alan White of Valparaiso Univ. Sch. of Law analyzing HAMP data), *available at* http://pubcit.typepad.com/clpblog/2010/02/latest-hamp-report-treasury-program-a-failure.html.

[42] *Id.*; Making Home Affordable Program Servicer Performance Report Through February 2010, U.S. Dept. of the Treasury, *available at* www.makinghomeaffordable.gov/docs/Feb%20Report%20031210.pdf

D. Clarify coverage of sale-leaseback and other title-transfer transactions

Sale-leaseback and other title-transfer transactions can be the most harmful of foreclosure rescue scams because they not only deprive a homeowner of scarce money but outright steal the homeowner's deed. Regarding how the proposed rule will affect these scams, the supplementary information says:

> As a general matter, the FTC does not intend the proposed Rule to address how title-transfer transactions are regulated. The Commission recognizes that there are many comprehensive state laws that govern these types of transactions and impose specific requirements when title transfers occur. To the extent sale-leaseback and title-reconveyance transactions are marketed as a means to avoid foreclosure, however, these purported services would be covered by the proposed Rule.[43]

We support the FTC's plan to regulate only the marketing of these scams while leaving further regulation to the states. Because these scams involve real property, laws addressing them must be sensitive to the many variations in real property law across the country. Marketing, however, has long been recognized as an appropriate subject for FTC regulation, especially because it often crosses state lines.

While we support the FTC's stated intent, we are concerned that the text of the proposed rule may produce an inconsistent result. The proposed definition of a MARS includes "Negotiating, obtaining, or arranging . . . [a]ny other disposition of a dwelling *other than a sale to a third party that is not the dwelling loan holder*" § 322.2(h)(6)(iii). This appears to exclude sale-leaseback and other title-transfer scams from the definition of a MARS because they typically involve "a sale to a third party that is not the . . . holder." In a title-transfer scams, the MARS provider convinces the homeowner to execute a deed transferring ownership of the homeowner's dwelling to a third-party. The third-party is typically the MARS provider, a business controlled by the provider, an *inter vivos* trust, or someone else (such as a strawman or a co-conspirator).[44] Any of these transfers constitutes "a sale to a third party that is not the dwelling loan holder." By the express terms of section 322.2(h)(6)(iii), such a transaction is not a mortgage assistance relief service and, accordingly, not subject to the proposed rule.

We encourage the FTC to clarify the definition of MARS to permit the FTC to regulate the marketing of these scams. One method of clarifying the definition would be to change clause (h)(6)(iii) to require sales to be bona fide: "[a]ny other disposition of a dwelling other than a *bona fide* sale to a third party that is not the dwelling loan holder."

E. Ensure that type style does not interfere with legibility of disclosures

The Commission has done an admirable job writing disclosure rules that will reduce the ability of MARS providers to obscure or overshadow mandatory disclosure statements. The FTC

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[43] 75 Fed. Reg. at 10,713 (footnote omitted).

[44] *See generally* Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure "Rescue" Scams, Nat'l Consumer Law Ctr. (June 2005), *available at* www.nclc.org/news/ForeclosureReportFinal.pdf.

should go further, however, by discouraging the excessive use of words printed in all-capital letters. While printing words in all-capital letters can make individual words or short phrases more prominent, printing long passages of text in this style makes the text more difficult to read. Researchers, typographers, and legal editors discourage the excessive use of text set in all-capital letters because it can negatively impact comprehension and slow reading speed. Segregating disclosures by printing them in all-caps text can have the perverse consequence of discouraging consumers from reading important information.[45] Reasonable alternatives are printing important text in bold, using a different or larger font, and segregating text with lines and boxes.

F. The FTC Should Consider Banning All Non-Attorney, For-Profit Loan Modification Services.

The record justifies banning all non-attorneys from providing any MARS, except for those having received extensive training, such as HUD-certified counselors, and doing so without charge. The record contains no evidence of a legitimate, for-profit, non-attorney MARS industry. Furthermore, one could reasonably argue that nearly all MARS involve the practice of law because they require interpreting and drafting contracts and knowledge of the foreclosure law and procedure in the homeowner's jurisdiction. For example, it is not unusual for mortgage servicers to provide modification contracts that require consumers to release their legal claims, waiver certain rights, or making the consumer liable for any deficiency remaining after a short sale. Based on the record and the skills required to provide most MARS, the FTC would be justified in banning the entire for-profit, non-attorney MARS industry.

G. The Definition of "Mortgage Loan Modification" Must Be Improved

The proposed fee restrictions regarding when a provider may be paid for a loan modification are currently inadequate to protect consumers. Section 322.5(b) and (c) currently state:

> (b) In cases where the provider has represented . . . that it will negotiate . . . a modification of any term of any dwelling loan, the provider shall not request or receive any payment or other consideration until it has:
>
> > (1) Obtained a mortgage loan modification for the consumer; and
> >
> > (2) Provided the consumer documentation of the mortgage loan modification in the form of a written offer from the dwelling loan holder or servicer to the consumer.
>
> (c) For the purposes of paragraph (b) of this section, "mortgage loan modification" means the contractual change to one or more terms of an existing

[45] One small study using U.S. Navy e-mail messages written in all-caps reported that participants “specifically disliked and found it difficult to locate important information using the all capital-letters format.” Sarah Greer et al., Email Format and Instructions: *Influences on Reading Times, Retention, and Preferences*, 1 Am. J. of Psychological Research 126 (2005). The study also observed that when participants knew they would not be questioned on the content read, “they spent the least amount of time reading emails in the all-capital-letter format, most likely because they did not like reading that format.” *Id.* at 128. Another article reported: “Upper case type is read about 13 percent slower than lowercase type.” *Id.* at 119 (citing M. Tinker, *Prolonged Reading Tasks in Visual Research*, 39 J. of Applied Psychology, 444–446 (1955)). “Most words contain some letters with ascenders/descenders, and this . . . creates rhythmic contrast in the exterior shapes of words written in lower or mixed case. Words written entirely in uppercase letters do not share this contrast . . . . Large amounts of text set in all caps are more difficult to read as a result of this lack of contrast.” Paul Kahn and Krzysztof Lenk, *Design: Principles of Typography for User Interface Design*, Interactions Magazine 18 (Nov/Dec. 1998). *See* Bryan Garner, Legal Writing in Plain English § 44 (2001) (discouraging use of all-capitals).

dwelling loan between the consumer and the owner of such debt that substantially reduces the consumer's scheduled periodic payments, where the change is:

(1) Permanent for a period of five years or more; or

(2) Will become permanent for a period of five years or more once the consumer successfully completes a trial period of three months or less.

In order to adequately protect consumers, the proposed rule should require the modification to be *affordable*, based on the ratio of the consumer's home-related debt to documented income. A modification that lowers the consumer's payments but is still unaffordable does not provide a genuine benefit to the homeowner and the MARS provider should not be paid for obtaining such a pyrrhic victory—especially because the provider will have access to the consumer's budget information and will be aware of what the consumer can afford before beginning negotiations with the mortgage servicer.

We also strongly recommend deleting subparagraph (c)(2), regarding trial periods. A modification that will only become permanent after a trial period is not a permanent modification—it is only a trial modification. The conversion of a trial modification to a permanent one is not as seamless as (c)(2) makes it appear. Instead, few trial modifications are being converted to permanent modifications under HAMP.[46]

Due to the way trial modifications have been implemented, homeowners are worse-off after entering into a trial modification. Even homeowners who are current upon entering a trial modification, and who make every trial modification payment in full and on time, receive derogatory credit reporting for the length of the trial modification, as having made payments under a special plan. This can result in lost jobs and rental housing, as well as higher priced credit. Because the trial modification payments are by definition less than the full contract payment under the mortgage, and the terms of the mortgage are not altered during the trial modification, homeowners accumulate an arrearage during the modification and finish trial modifications owing more on their homes than when they started. Consumer advocates have seen servicers use these arrears, accumulated during the trial modification, as the basis for initiating a foreclosure against a homeowner who was not granted the conversion to a permanent modification. Accordingly, it is essential that the definition of "mortgage loan modification" in subsection 322.5(c) only apply to permanent modifications.

When a consumer pays a substantial sum to a for-profit MARS service, the consumer expects to receive a *permanent* modification. Section 322.5 should not allow MARS providers to charge for temporary modifications.

The rule should also prohibit the modified loan from having a maximum interest rate that exceeds the maximum rate permitted by HAMP at the end of the period or trial period described

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[46] *See* Corbett B. Daly, Treasury says 1 million homeowners in loan modifications, Reuters (Mar. 12, 2010), *available at* www.washingtonpost.com/wp-dyn/content/article/2010/03/12/AR2010031202339.html (less than ten percent of eligible borrowers receive permanent modifications); Alan White, Latest HAMP report: Treasury program a failure, Consumer Law & Policy Blog (Feb. 17, 2010) (Prof. Alan White of Valparaiso Univ. Sch. of Law analyzing HAMP data), *available at* http://pubcit.typepad.com/clpblog/2010/02/latest-hamp-report-treasury-program-a-failure.html.

in paragraphs (1) and (2). Under HAMP the maximum interest rate on a modified loan may not exceed "the Freddie Mac Weekly Primary Mortgage Market Survey (PMMS) Rate for 30-year fixed rate conforming loans, rounded to the nearest 0.125 percent, as of the date that the [Modification] Agreement is prepared."[47] The FTC need not include a specific rate cap in the rule so long as the rule refers to the HAMP guidelines. This is appropriate because Congress has previously specified that the HAMP procedures are deemed "standard industry practice for purposes of all Federal and State laws."[48]

V. Conclusion

The Federal Trade Commission has proposed a good rule that will give consumers strong protections that have been absent too long. Without some improvements, however, the rule could have negative consequences that may outweigh any benefits. The exemption for attorneys is too narrow and will drive out legitimate attorneys who currently perform invaluable services that consumers will not find elsewhere. It would be cruelly ironic if a rule designed to protect homeowners from scams also eliminated one of their best allies in fighting scammers.

While we are appalled by attorneys who have abused their position to taking advantage of desperate homeowners, attorneys as a whole are reliable and should be exempt from the proposed rule *if* they meet certain criteria designed to weed-out abuse and misconduct. 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 MARS entities run by non-attorneys are under no such obligation, do not have the same educational requirements, and are subject to far less, if any, supervision. The exemption criteria we have proposed would enable legitimate attorneys to continue providing bona fide legal services that are within the proposed MARS definition.

We also urge the FTC to include several other protections that have been omitted from the rule. Any modification obtained by a MARS provider should be permanent and should have a maximum interest rate that complies with the existing HAMP guidelines. This will ensure that consumers are not tricked into paying for modifications that provide only temporary relief and merely defer the affordability problem a few years in the future. This is not a price control rule. The HAMP guidelines are standard industry practice for purposes of all state and federal laws.

Homeowners should also have the right to cancel a MARS contract for any reason. Contracts to provide MARS are of dubious value, as clearly shown by the NPR. Homeowners are much better served by free, nonprofit HUD counselors and should not be bound to a for-profit provider. Any contract for MARS that violates the proposed regulation should automatically be voided by operation of the rule and the provider should be required to disgorge any money obtained in the course of the void contract. Without such a provision, the rule will be largely

[47] Home Affordable Modification Program, Supplemental Directive 09-01at 9 (Apr. 6, 2009).
[48] Section 129 of the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632 (2009) says: "The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State laws."

toothless because state and federal regulators lack the resources to fully pursue the many complaints filed against MARS providers.

Respectfully Submitted,

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Exhibit 1

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

[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.

[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

[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]

[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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