LAWYERS' COMMITTEE FOR
CIVIL RIGHTS
UNDER LAW
A nonprofit, nonpartisan legal organization formed at the request of President Kennedy in 1963
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March 29, 2010

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex W)
600 Pennsylvania Avenue N.W.
Washington, D.C. 20580

Submitted electronically

Re: RIN 3084-AB18
Notice of Proposed Rulemaking, Mortgage Assistance Relief Services
16 CFR Part 322
75 Fed. Reg. 10707 (March 9, 2010)

Dear Mr. Clark:

The Lawyers' Committee for Civil Rights Under Law (hereinafter the Lawyers' Committee) extends it sincerest appreciation for the Federal Trade Commission's (hereinafter, FTC) efforts to create a regulatory framework that will hinder the unfair and deceptive practices that are proliferating in the exploding mortgage assistance market. In this time of unprecedented rates of foreclosure affecting millions of households, a disproportionate number of which are minority households, loan modification scams compound these losses in communities already suffering because lax oversight permitted predatory lending practices to push so many minority homeowners past the brink of sustainable homeownership. The Lawyers' Committee welcomes the FTC's dedication to fighting this scourge and appreciates this opportunity to provide comment on the above-captioned proposed Rule regarding mortgage assistance relief services.

The Lawyers' Committee, a nonpartisan, nonprofit organization, was formed in 1963 at the request of President John F. Kennedy to involve the private bar in providing legal services to address racial discrimination. The principal mission of the Lawyers' Committee is to secure,

through the rule of law, equal justice under law. Given our nation's history of racial discrimination, de jure segregation, and the de facto inequities that persist, the Lawyers' Committee's primary focus is to represent the interest of African-Americans in particular as well as other racial and ethnic minorities and victims of discrimination, where doing so can help to secure justice for all racial and ethnic minorities. The Lawyers' Committee implements its mission and objectives by marshaling the pro bono resources of the bar for litigation, public policy advocacy, and other forms of service performed by lawyers to the cause of civil rights.

Presently, the Lawyers' Committee's top fair housing priority is addressing the civil rights issues arising from the record-breaking foreclosure crisis that is diminishing the future prospects of millions of American homeowners.[1] This crisis is particularly acute for people of color. As one of the co-authors of the December 2008 report entitled "The Future of Fair Housing: Report of the National Commission on Fair Housing and Equal Opportunity,"[2] the Lawyers' Committee stressed the disproportionate impact that foreclosures are having on minority communities, in large part because of the disproportionate share of subprime and predatory home loans made to members of these communities under the guise of providing 'access to credit' in historically underserved areas.[3] Studies show that, regardless of credit score, minority homeowners were many times more likely than white homeowners to be steered into subprime loans, which were often unaffordable in real terms, as well as predatory loans that were unsustainable by design.[4] Analyses of raw lending data pursuant to the Home Mortgage Disclosure Act of 1975[5] have repeatedly demonstrated that lending discrimination has continued unabated.[6]

Even more critical to African-American and Latino homeowners is that their wealth accumulation is more likely to be concentrated in their home, rather than diversified among

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[1] For a detailed discussion, see Testimony of Barbara Arnwine, Executive Director, Lawyers' Committee for Civil Rights Under Law before the House of Representatives Committee on the Judiciary, Subcommittee on the Constitution, Civil Rights and Civil Liberties, Mar. 11, 2010, on file with the Lawyers' Committee.

[2] *The Future of Fair Housing: Report of the National Commission on Fair Housing and Equal Opportunity* (Dec. 2008), *available at* http://www.lawyerscommittee.org/admin/site/documents/files/0005.pdf.

[3] *Id*. at 32-33.

[4] *Id*. at 33.

[5] Home Mortgage Disclosure Act of 1975, 12 U.S.C. § 2801 *et seq*. (1975).

[6] *See, e.g.*, Debbie Bocian et al., Center for Responsible Lending, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages* (May 31, 2006) *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/unfair-lending-the-effect-of-race-and-ethnicity-on-the-price-of-subprime-mortgages.html.

various holdings such as business assets or equity investments.[7] As a result, the foreclosure crisis has caused perhaps the greatest loss of wealth for African-American households in the country's history.[8] African-Americans and Latinos are projected to lose between $71 and $93 and $75 to $98 billion, respectively, through foreclosure.[9]

Now, we are witnessing the second wave of the foreclosure crisis – the rapid proliferation of mortgage rescue and loan modification scams that steal the last dollars and hope from homeowners who are, in every instance, struggling to pull together enough money to bring their mortgages current. The severity of this type of fraud is reflected in the increased law enforcement actions and filings, from the FTC to state and local government prosecutors and regulators. In November 2009, an Interagency Financial Fraud Enforcement Task Force, which includes a working group devoted solely to mortgage rescue scams, was announced by Attorney General Eric Holder, Department of Treasury Secretary Tim Geithner, Housing and Urban Development Secretary Shaun Donovan, and Securities and Exchange Commission Chairwoman Mary Schapiro.[10] A report issued in February 2010 by the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) for the third quarter of 2009 included a special section on Loan Modification/Mortgage Rescue Frauds and noted "an increasing number of Suspicious Activity Reports submitted to them noting suspicious activity in connection to actual or purported foreclosure rescue specialists." [11] Moreover, the report identified the practice of charging advance fees followed by a failure to take any action on the borrower's behalf as one of the two most commonly reported fraudulent schemes.[12]

In response to this increase in fraud related to mortgage assistance relief services, or MARS, the Lawyers' Committee has joined with federal, state and local governmental, non-profit and private organizations to create the Loan Modification Scam Prevention Network (the

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[7] *The Future of Fair Housing, supra* note 2, at 34.

[8] *Id*.

[9] Amaad Rivera et al., *Foreclosed: State of the Dream 2008* (Jan. 15, 2008), *available at* http://www.faireconomy.org/files/StateOfDream_01_16_08_Web.pdf. Sadly, these homeowners' share of foreclosure losses are at minimum 27% higher than they should be due to predatory home loans targeting these borrowers. *Id.*

[10] Press Release, U.S. Securities and Exchange Commission, President Obama Establishes Interagency Financial Fraud Enforcement Task Force (Nov. 17, 2009), *available at* http://www.sec.gov/news/press/2009/2009-249.htm.

[11] Press Release, Financial Crimes Enforcement Network, FinCEN Issues Mortgage Loan Fraud Update; Warns of Foreclosure Rescue Scam Techniques (Feb. 18, 2010), *available at* http://www.fincen.gov/news_room/nr/pdf/20100218.pdf.

[12] *Id*.

Network), a national coalition working to educate the public and to support enforcement activity at all levels of government to help in the fight against loan modification scams. As a leader of the Network, the Lawyers' Committee is compiling data on loan modification scam activity into its national Database for use by enforcement officials, and is making this information and other tools and resources available to homeowners and service providers through its new web portal, www.PreventLoanScams.org.

The Lawyers' Committee supports the prohibition on the collection of advance fees.

We applaud the proposed Rule's clarity with respect to the ban on the collection of advance fees by for-profit entities purporting to provide MARS. The proposed Rule's ban on advance fees is important in and of itself simply because it stops the transfer of large lump sums away from consumers in need and who, by definition, have very limited liquidity to parties that, at best, are unjustly enriched or, at worst, have committed fraud. The ban will increase the ability of homeowners to apply those monies more effectively to their intended goal of saving their home. The ban will also protect struggling homeowners by incentivizing MARS providers to represent their capabilities in a way that reflects services they can realistically provide in a timely manner. After all, the sooner the providers are able to make good on the representations to the consumer, the sooner they will be able to charge their fees.

While certain non-profit MARS providers charge a nominal fee for specific administrative costs such as obtaining a credit report, it does not necessarily follow that a for-profit provider should be able to do the same. The for-profit business should be able to capitalize its business in a manner so that it can carry forward these nominal fees as operating costs and then incorporate that operating cost into the fee obtained from the consumer <u>after</u> the services are rendered.

The proposed Rule should be further clarified to ensure that MARS providers confer an actual benefit on consumers before demanding and collecting compensation.

Under §§ 322.5(b) and (c) of the proposed Rule, MARS providers who represent that they will obtain a loan modification can be compensated only if they have provided a written offer of a modification from the loan holder/servicer to the consumer. In addition, this modification must be a contractual change to the mortgage that "substantially reduces the consumer's scheduled periodic payments" and is permanent for five years or more or will be permanent for five years or more after a successful three-month trial period.

We believe that MARS providers who negotiate mortgage loan modifications for homeowners in exchange for compensation must confer a real benefit in the form of a modified mortgage that is affordable and sustainable. This past February and March, we spoke to homeowners who attended the Department of Treasury's Making Home Affordable/HOPE NOW

foreclosure assistance events in Sacramento, California and Phoenix, Arizona. At the events, we heard reports that some "loan modification consultants" claim to have fulfilled their part of the bargain and demand payment after obtaining modifications with terms that are financially worse than the original mortgages. Such deceptive acts are unacceptable. To ensure that homeowners receive a real benefit for the services offered, MARS providers who promise to obtain loan modifications should be required to achieve results that truly help consumers and do not lead to future re-defaulting. Re-default among homeowners who obtain loan modifications is a major concern. The Mortgage Metrics Report for the third quarter of 2009, published by Office of the Comptroller of the Currency and Office of Thrift Supervision, illustrates this problem. The Report's data for 2008 and early 2009 show that an increasing number of consumers who modify their mortgages become delinquent over time.[13] For example, in the fourth quarter of 2008, within three months of modifying their loans, 47% of consumers became 30 or more days delinquent.[14] This percentage increased to 57% within six months after the modification.[15] The numbers for the first quarter of 2009 are similar with 46% becoming 30 days or more delinquent within three months and 56% after six months.[16] The second quarter of 2009 yielded an improved, but still problematic, number of 34% for loans re-defaulting three months after modifications.[17] Indeed, on March 25, 2010, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) issued its report on the Home Affordable Modification Program (HAMP) and noted that the Treasury Department has estimated that four out of ten homeowners whose mortgages are modified under the HAMP program "will re-default and potentially be in danger of losing their homes to foreclosure" in the future.[18]

To prevent re-defaulting, recent research suggests that loan modifications should reduce monthly mortgage payments as well as decrease mortgage interest rates and/or principal amounts. In 2009, the Center for Community Capital at the University of North Carolina at Chapel Hill analyzed approximately 10,000 modified loans and found that, six months after receiving a modification, homeowners whose payments increased slightly because they got a

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[13] Office of the Comptroller and the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report* (Third Quarter 2009), *available at* http://files.ots.treas.gov/482114.pdf.

[14] *Id*. at 31.

[15] *Id*.

[16] *Id.*

[17] *Id*.

[18] Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting the Implementation of the Home Mortgage Affordable Program*, March 25, 2010, p. 15, *available at* www.sigtarp/reports/audit/2010/factors_affecting_implementation_of_the_home_affordable_modification_program.pdf.

"traditional modification," [19] had a 22% higher rate of re-default than those whose modification led to a reduced payment.[20] In addition, homeowners who obtained an interest rate reduction were about 13% less likely to re-default than similar homeowners in similar situations who received a traditional modification.[21] Those homeowners whose rate reduction was also accompanied by a principal reduction were 19% less likely to re-default.[22] These findings are in accordance with a study done by the Federal Reserve Bank of New York in December 2009 indicating that, while modifications which reduced monthly payments were far more likely to succeed than those that did not, reduced monthly payments that included principal write-downs were more successful in avoiding re-defaults than those that only reduced interest rates.[23] The study further suggested that loan modifications with loan write-downs could double the reduction in re-default rates achieved by payment reductions alone.[24]

Based on the current research, we believe that the proposed Rule is on the right track in requiring MARS providers to achieve loan modifications that "substantially" reduce the consumers' scheduled periodic payments permanently over a period of time. However, according to the language of the proposed Rule, it is unclear what kind of mortgage payment reduction would be "substantial." While we agree that any reduction resulting from a modification should provide true assistance for homeowners who are experiencing financial hardship, the term "substantially" can be open to interpretation and, therefore, confusion when applied to real situations. Therefore, we suggest that the term be replaced by specific markers indicating "affordable" and "sustainable" loan modifications, which MARS providers should be required to achieve.

The City of San Francisco's ordinance regulating "mortgage modification consultants" provides a helpful guide to determine what these "affordable" and "sustainable" loan modifications could look like. Specifically, the local law requires that to be compensated, a

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[19] Traditional modification in this context describes adding past due amounts to the outstanding principal balance then re-amortizing the outstanding amount over the remaining loan term,

[20] Roberto G. Quercia et al., Center for Community Capital at the University of North Carolina at Chapel Hill, *Loan Modifications and Redefault Risk: An Examination of Short-term Impact*, (Working Paper: March 2009), *available at* http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf, at 10.

[21] *Id*. at 14.

[22] *Id*.

[23] Andrew Haughwout et al., Federal Reserve Bank of New York Staff Reports, *Second Chances: Subprime Mortgage Modification and Re-Default* (Dec. 2009), *available at* http://www.newyorkfed.org/research/staff_reports/sr417.pdf.

[24] *Id*. at 27, 29.

mortgage modification consultant must obtain a written offer of a modification for the homeowner through an interest rate reduction, principal reduction/forbearance, or term extension that does one or both of the following: (1) reduces the homeowners' monthly loan payment (principal and interest) by at least 20% for a minimum of five years; or (2) reduces the homeowner's monthly payment for housing expenses to no more than 31% of the homeowner's monthly gross income for a minimum of five years.[25]

We recommend that the proposed Rule include a provision like the one in the San Francisco ordinance, which mandates providers to obtain loan modifications that include measures shown to prevent future re-defaulting (i.e. decreasing mortgage payments along with reducing interest rates, principal amounts, or extending loan terms). The numbers from the Making Home Affordable Program indicate that such practices are already common among servicers/lenders allowing permanent loan modifications. In February 2010, the Making Home Affordable Program's Servicer Performance Report showed that 100% of homeowners in permanent modifications had interest rate reductions, 41% received term extensions, and 28% obtained principal forbearance.[26] In addition, the median savings for homeowners in these permanent modifications was 36% of the median before-modification payment – a percentage much higher than the 20% required by the San Francisco ordinance.[27] Therefore, including similar requirements for modifications into the FTC Rule would memorialize the existing practice. In addition, the proposed Rule should mirror the HAMP goal of getting the homeowner to monthly housing payments that do not exceed 31% of the homeowner's gross income.

The Lawyers' Committee recommends incorporating a cap on compensation for MARS providers into the proposed Rule.

We recommend that fees collected for services rendered be capped. A cap on fees ultimately charged will work in conjunction with the ban on advance fees to exert pressure on the transaction that occurs between the homeowner and the MARS provider in favor of the homeowner. Without a cap, the MARS provider can still make less-than-accurate representations about its services by making them appear to be worth a substantial sum, but not in ways that rise to outright misrepresentations. For example, the providers can make representations based on the purported complexity of the transaction, the seniority level of the persons involved with helping the homeowner, or the potential size of the team that will be put to work on the homeowner's behalf. These are only a few ways that a MARS provider could 'pad'

[25] San Francisco, Cal., Police Code art. 27, § 2703(b) (2009).

[26] Making Home Affordable Program Servicer Performance Report Through February 2010, *available at* http://www.treas.gov/press/releases/reports/february%20hamp%20report.pdf.

[27] *Id*.

the services so that, even if the services are rendered, the homeowner still may be unfairly overcharged. Similar to the court-imposed reasonableness standard that caps administrative fees in bankruptcy proceedings, a limit on MARS fees would help ensure that the cost and components of the services provided to distressed homeowners remain proportionate to the value MARS providers actually provide.

In addition to limits on fees in bankruptcy, there are other analogies to such caps on services marketed as assistance to consumers who are severely constrained financially or have limited means.[28] In fact, in the Notice itself, the FTC solicits comment on the propriety of analogizing to the limitations imposed on the provision of debt relief services.[29]

We believe it would be sensible to cap MARS fees at reasonable flat rates that cover the total compensation for the entirety of the services provided. However, we submit that intermediate charges or piecemeal billing should not be permitted. In addition, the FTC should consider a limit of one MARS transaction per address that is at risk of foreclosure. The scope of a "transaction" should be defined as services provided to achieve the ultimate agreed-upon outcome, rescuing that home from foreclosure. This requirement would further limit the MARS provider's ability to drive up fees by either breaking up the services under one contract or spreading the services out among several contracts. The fee amount could also be capped at a percentage of the consumer's current income. A cap based on income would also help to ensure that only those who had an income sufficient to pay a mortgage on an ongoing basis would be sold MARS services.

These fee caps may result in a slower or non-existent entry into this market by financial advisors and other similarly situated service providers. However, much like federal tax return preparation as a means to facilitate refund anticipation loans, in most cases, MARS are services that are available at little or no cost from the institutions that are best-situated to provide the relief sought. In almost every instance of loan modification, the MARS provider is essentially a middle man inserting itself into a process that should function adequately without its presence. We must, therefore, consider limiting the price of whatever value might be added in such case, as well as the costs versus the benefits of inserting the middleman into the process.

The Lawyer's Committee recommends that the FTC revisit the Section 322.7 exemptions. The proposed Rule's current Section 322.7 (b) could unduly restrict access to legitimate mortgage assistance provided in the ordinary course of legal representation. Conversely,

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[28] *See generally* Fed R. Bankr. P. 2016, Compensation for Services Rendered and Reimbursement of Expenses; Fed. R. Bankr. P. 2017, Examination of Debtor's Transactions with Debtor's Attorney.

[29] Notice of Proposed Rulemaking, Mortgage Assistance Relief Services, 75 Fed. Reg. 10707, 10719 (Mar. 9, 2010).

the Section 322.7(a) exemption is unnecessary and may facilitate existing unfair practices among MARS providers.

The intersection between legal services and mortgage assistance relief services is well documented in the increasing reports of attorneys teaming up with MARS providers to scam consumers. There are even attorneys operating independently who have engaged in scamming. For example, "law enforcement agencies throughout California, as well as the State Bar, have received thousands of complaints from homeowners over the last year that they have been victimized by phony businesses that used attorneys as fronts to collect advance fees and then performed no work."[30] For this reason, it is important that the teeth of the FTC's proposed Rule apply to both attorneys and non-attorneys.

At the same time, given the unique and specialized service of the legal profession and the legitimate need for legal advice in certain loan modifications situations, we recognize the need for certain exemptions. The exemption from the ban on advance fees codified in § 322.7(b) will allow attorneys to continue to represent individual clients in their traditional capacity by obtaining standard retainer fees in bankruptcy, foreclosure and other legal actions involving the filing of documents in a court or administrative proceeding.[31] However, this exemption is more restrictive than many state exemptions since it only permits the collection of advance fees in the context of specific legal actions. While the FTC importantly points out that a broad exemption for attorneys would permit non-attorney MARS providers to team up with attorneys to get around the advance fee ban altogether,[32] too narrow an exemption has the potential to hinder homeowners in receiving legitimate legal services. The FTC explains that, by restricting the exemption to specific legal actions, it will be "easier for federal and state law enforcement officials to determine whether an attorney in fact qualifies for the exemption."[33] However, in many situations short of legal action, there is a legitimate need for attorneys to provide legal advice or transactional services to their clients. For example, it may not be possible for an attorney to know whether he/she will file documents in a court proceeding or if bankruptcy is the best course for a client at the outset of representation. Under the current exemption, attorneys in

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[30] *Southern California Attorney Arrested for Loan Modification Activities*, California Bar Journal (March 2010), *available at* http://calbar.ca.gov/state/calbar/calbar_cbj.jsp?sCategoryPath=/Home/Attorney%20Resources/California%20Bar%20Journal/March2010&sCatHtmlPath=cbj/2010-03_TH_01_socalattorneyarrested.html&sCatHtmlTitle=Top%20Headlines.

[31] It is a common practice within the legal industry for an attorney to receive an advance fee called a "retainer" from a client. This fee is put into a special trust account until such time as the attorney has performed work warranting the fee.

[32] 75 Fed. Reg., *supra* note 27, at 10723.

[33] *Id.* at 10725.

this situation could not charge retainer fees for fear of running afoul of this rule. Similarly, transactional attorneys appear to be completely banned from charging a retainer fee to their clients. While the Lawyers' Committee applauds the FTC for recognizing the importance of banning the collection of advance fees by MARS providers, we are concerned that the current attorney exemption may be too narrow.[34]

Alternatively, the exemption codified in §322.7(a) is both unnecessary and potentially problematic. It is unclear why an attorney would need "in connection with the advertising, marketing, promotion, offering for sale, or sale of any mortgage assistance relief service" to advise a consumer not to communicate with his or her lender as described in §322.3(a).[35] Within the context of an attorney-client relationship, there are cases where an attorney would advise the client not to contact the lender. For example, in an active foreclosure or bankruptcy case, the consumer's attorney may recommend that all communication to the lender be made through the attorney. However, that sort of advice could only ethically be made on a case-by-case basis. Therefore, no ethical attorney in good standing with a state bar association should give such advice in the advertisement of services. It is unclear when, if ever, the exemption provided in § 322.7(a) would be necessary in the ethical practice of law.

Furthermore, the exemption in § 322.7(a) is potentially problematic as it creates a loophole for non-attorney MARS providers and has the potential to add to consumer confusion and deception through irresponsible attorney advertising. Just as non-attorney MARS providers have partnered with attorneys to avoid state laws banning advance fees, we should also expect them to partner with attorneys to get around a ban on telling consumers not to contact their lenders. After all, one of the most common loan modification scams is a scheme where the scammer tells the consumer not to contact his or her lender or to make payments to the scammer rather than the lender, only to do little or nothing, leaving the consumer in greater trouble with his or her lender.[36] Additionally, this exemption may result in some attorneys providing MARS to be less careful of the language they use in their advertising, even if their intent is not to defraud consumers. For example, attorneys advertising about MARS may boast in their advertisements that consumers will no longer have to deal with their lenders (because the attorney will be the vessel for communication). Taken in the context of a quick sound bite or

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[34] The Lawyers' Committee is in agreement with the more in-depth comments submitted by the National Consumer Law Center (on behalf of its low-income clients), National Association of Consumer Advocates, the Virginia Poverty Law Center, and others regarding the proposed Rule's Section 322.7(b).

[35] *Id.* at 10735.

[36] Office of Comptroller of the Currency, Consumer Advisory, CA-2009 1, *OCC Consumer Tips for Avoiding Mortgage Modification Scams and Foreclosure Rescue Scams* (Apr. 21 2009), *available at* http://www.occ.treas.gov/ftp/ADVISORY/2009-1.html.

print ad rather than a one-on-one consultation in an established attorney-client relationship, the consumer may confuse the advertisement for general legal advice.

While removing this exemption will help to eliminate consumer confusion, it will not limit the consumer's ability to seek legal services for their mortgage-related problems nor will it prevent lawyers from advertising that they provide MARS, foreclosure or bankruptcy services. It is not necessary for an attorney to tell a consumer they will not have to contact their lender to advertise these services. Removing the exemption would not prevent an attorney from advising an individual client on a case-by-case basis to cease communication with his or her lender since the ban only covers such advice in the advertising and sale of services. Providing such advice to an individual client is proper in the context of an established attorney-client relationship, but can be problematic in the context of advertising legal services.

While there must be a balance between protecting the consumer and allowing an attorney to operate within industry standards of the legal profession, the exemption in § 322.7(a) may actually be detrimental to consumers and promote the very sort of scamming the FTC is trying to prevent.

In conclusion, we appreciate the opportunity to comment on the FTC's proposed Rule and again commend the FTC for creating enforcement provisions that hopefully will slow, and eventually help to stop the rising tide of unfair and deceptive business practices related to foreclosure that are thriving in the current economic environment. If we can provide the FTC with any additional information, we can be reached at the address set forth below.

Sincerely,

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