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LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

MAY 6, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–28

U.S. GOVERNMENT PRINTING OFFICE

51–587 PDF WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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CONTENTS

	Page
Hearing held on:	
May 6, 2009	1
Appendix:	
May 6, 2009	37

WITNESSES

WEDNESDAY, MAY 6, 2009

Anderson, John W., Vice Chair, Federal Housing Policy Committee, National Association of Realtors (NAR)	26
Coakley, Hon. Martha, Attorney General, Commonwealth of Massachusetts	7
Drexel, Scott J., Chief Trial Counsel, The State Bar of California	22
Freis, James H., Jr., Director, Financial Crimes Enforcement Network (FinCEN), U.S. Department of the Treasury	4
Saunders, Lauren, Managing Attorney, National Consumer Law Center	20
Story, Robert E., Jr., Chairman-Elect, Mortgage Bankers Association (MBA)	24
Twohig, Peggy, Associate Director, Division of Financial Practices, Bureau of Consumer Protection, Federal Trade Commission (FTC)	5

APPENDIX

Prepared statements:	
Anderson, John W.	38
Coakley, Hon. Martha	49
Drexel, Scott J.	57
Freis, James H., Jr.	66
Saunders, Lauren	75
Story, Robert E., Jr.	98
Twohig, Peggy	104

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Waters, Hon. Maxine:	
Written responses to questions submitted to John W. Anderson	117
Written responses to questions submitted to Hon. Martha Coakley	120
Written responses to questions submitted to Scott J. Drexel	126
Written responses to questions submitted to James H. Freis, Jr.	131
Written responses to questions submitted to Lauren Saunders	138
Written responses to questions submitted to Peggy Twohig	145
Capito, Hon. Shelley Moore:	
Written statement of Florida Attorney General Bill McCollum	153

LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD

Wednesday, May 6, 2009

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND
COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the subcommittee] presiding.

Members present: Representatives Waters, Lynch, Cleaver, Green, Ellison, Driehaus, Himes, Maffei; Capito, Jones, Putnam, Jenkins, and Lee.

Also present: Representative Moore of Wisconsin.

Chairwoman WATERS. This hearing of the Subcommittee on Housing and Community Opportunity will come to order. Good morning, ladies and gentleman. I would like to thank our ranking member, Shelley Moore Capito, and the other members of the Subcommittee on Housing and Community Opportunity, for joining me today at this hearing entitled, "Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud."

I believe that this hearing is critical, given the emergence of a new type of criminal actor in the housing market, at a time when the U.S. economy is still reeling from subprime meltdown. We are witnessing homeowners being taken advantage of by predators claiming they can modify their loans or prevent foreclosure.

Today's hearing will help identify legislative solutions to put an end to loan modification and foreclosure rescue fraud. These scam artists portray themselves as foreclosure consultants, and offer to rescue or help struggling homeowners stay in their homes through aggressive marketing campaigns. For a fee, these individuals or entities promise to help save homes from foreclosure, but either charge an excessive fee for services that can be obtained for free by a qualified nonprofit counseling agency, or deliver little or nothing for the money received.

In addition, loan modification consultants are also entering the market, claiming to have established relationships in the mortgage industry which will enable them to negotiate better loan modification terms than borrowers could do for themselves. They can charge as much as 2 percent of the loan amount to negotiate with the homeowner's market servicer, but often deliver either nothing

or a higher payment than the homeowner was paying before contacting these companies. These companies often use terms such as "Federal," to mislead borrowers into thinking they are official U.S. programs.

In response to this growing crisis, Federal agencies have begun to take action. Earlier this month, Treasury Secretary Timothy Geithner announced the establishment of the multi-agency task force to address foreclosure rescue and loan modification fraud, including the Department of Justice, HUD, and the FTC, State investigators and prosecutors, civil enforcement authorities, and the private sector.

States have also taken action to protect their citizens and stop these criminal actors. I commend those States that are aggressively addressing foreclosure rescue scams. For example, earlier this month, Massachusetts Attorney General, the Honorable Martha Coakley, a witness on our first panel, filed lawsuits against four individuals claiming to be loss mitigation specialists who were falsely claiming to be 1 of 14 firms recruited by the government to provide foreclosure prevention services.

Although a number of States have enacted foreclosure rescue fraud statutes that would prohibit advanced fees and/or require written contracts for all foreclosure-related services, many of these statutes exempt attorneys or real estate brokers. Because attorneys are allowed to charge up-front fees, fraudulent loan modification companies contract with law firms to use their name. For example, the Federal Loan Modification Law Center was able to skirt California law by contracting with lawyers so they could receive up-front fees.

During the Financial Services Committee mark-up of H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, I worked with Congresswoman Gwen Moore on an amendment she authored and withdrew, which was similar to her bill, H.R. 1231, the Foreclosure Rescue Fraud Act of 2009, that would prevent the practices of foreclosure consultants such as charging up-front fees for services, acquiring interest in the property, or receiving a lien on the property.

In addition, Ms. Moore's amendment renewed the exemption for attorneys, except for those filing non-frivolous bankruptcy petitions or proceedings to prevent a foreclosure.

As this bill moves through Congress, we want to make sure that it will effectively put a stop to the deceptive practices of foreclosure rescue and loan modification scam artists. That is why this hearing is so important today.

Again, I look forward to hearing the witnesses' views on this very important issue, and I would now like to recognize Ranking Member Capito for her opening statement.

Mrs. CAPITO. Thank you. I would like to thank Chairwoman Waters for recognizing me. I would also like to ask unanimous consent to submit for the record the written testimony of Florida Attorney General Bill McCollum on this very topic.

Chairwoman WATERS. Without objection, it is so ordered.

Mrs. CAPITO. Thank you. While many Americans across the Nation continue to struggle with meeting their obligations, there are those in our society, unfortunately, who are taking advantage of

families who are already stressed, which I believe is unacceptable. The actions of these unscrupulous individuals are an example of the worst in human nature, and they should be held to the most stringent criminal procedures and penalties.

According to the Mortgage Bankers Association, in the most recent national delinquency survey a record number of borrowers are delinquent on their mortgages, and entering foreclosure. Given the recent uptick in distressed borrowers facing delinquency, borrowers often—some borrowers have fallen victim to foreclosure prevention and loan modification fraud scams.

On February 10, 2009, the Treasury Secretary announced a series of plans intended to help struggling homeowners. As a follow-up to increased reports of fraud, on April 6, 2009, the U.S. Department of the Treasury's Financial Crimes Enforcement Network, FinCEN, issued guidance to financial institutions on filing suspicious activity reports regarding loan modification foreclosure rescue scams.

In addition, States like Florida—as the chairwoman noted—Nevada, California, Illinois, Maryland, and Minnesota have all taken action to combat mortgage and foreclosure assistance fraud.

Following the FinCEN announcement of guidance on April 6th, the regulators must continue to utilize existing authority to protect consumers, and maintain the safety and soundness of home financing.

One key aspect that will aid in this are the national licensing standards and registration database for all mortgage originators that was signed into law last year. This will help in preventing bad actors from preying on borrowers and homeowners by providing greater accountability and professionalism in the industry. But it is critical that Congress exercise rigorous oversight to ensure these abusive practices are halted, and those responsible for carrying them out are punished.

I would like to thank the chairwoman for holding this hearing. I would also like to thank Ms. Moore for offering her legislative proposal on foreclosure, H.R. 1231. I look forward to hearing from our witnesses, and learning their thoughts on how Congress and regulators can prevent further abuse and fraud.

And I yield back. Thank you.

Chairwoman WATERS. Thank you very much.

Mr. Lee?

Mr. LEE. I do not have an opening statement.

Chairwoman WATERS. No opening statement? Thank you very much. Then we will go right to our panel.

Our first witness will be Mr. James Freis, Director of the Financial Crimes Enforcement Network at the U.S. Department of the Treasury.

Our second witness will be Ms. Peggy—I think that's Twohig—when you come, you can correct me—Associate Director in the Division of Financial Practices at the Bureau of Consumer Protection at the Federal Trade Commission.

And our third witness will be the Honorable Martha Coakley, attorney general of Massachusetts.

Would you please come forward? There we are. Thank you very much. And, Ms. Peggy Twohig, would you please tell me the correct pronunciation of your name?

Ms. TWOHIG. "Twohig."

Chairwoman WATERS. "Twohig?" All right. Thank you. We will start with Mr. "Freis," is it? Is that the correct pronunciation?

Mr. FREIS. That is correct.

Chairwoman WATERS. Thank you.

STATEMENT OF JAMES H. FREIS, JR., DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK (FinCEN), U.S. DEPARTMENT OF THE TREASURY

Mr. FREIS. Good morning. Chairwoman Waters, Ranking Member Capito, and distinguished members of the subcommittee, I am Jim Freis, the Director of FinCEN. I appreciate the opportunity to appear before you today to discuss our work in combating mortgage loan fraud, and our role in the Administration's efforts to address the current foreclosure rescue fraud problem.

FinCEN has unique authorities to make contributions to this regard. Congress placed us at the intersection of law enforcement and the regulatory communities, as well as the financial industry. FinCEN's basic purpose is to safeguard the financial system from the abuses of financial crime. Pursuant to the Bank Secrecy Act, FinCEN issues regulations, notably including requirements that financial institutions monitor for and report suspected fraudulent activity. FinCEN analyzes these suspicious activity reports, also known as SARs, in support of its regulatory and law enforcement functions.

FinCEN first focused on analyzing trends and patterns related to mortgage fraud back in 2002. It has since become apparent that SAR data was a leading indicator that mortgage loan fraud was a serious escalating problem.

In November 2006, FinCEN published the first in a series of analytical reports in an effort to provide the financial industry with red flag indicators that could help them protect their financial institutions and their customers from being victims of fraud. We greatly value our partnership with the financial industry to advance our shared goals of protecting against abuse of the financial system.

Subsequent FinCEN mortgage fraud studies have focused on the role of complicit insiders, how fraud can be uncovered during foreclosures, and how criminal activity is interconnected, transcending multiple financial sectors.

In addition to the published analytical reports, FinCEN provides both strategic and tactical support to Federal and State law enforcement and financial regulatory communities to investigate and prosecute fraud.

FinCEN has a long history of supporting law enforcement efforts to root out fraud, waste, and abuse in government programs. Recently, FinCEN joined a multi-agency task force headed by the Special Inspector General for the Troubled Asset Relief Program, the SIGTARP, as part of a proactive initiative to deter, detect, and investigate instances of fraud in some of the Administration's programs under the financial stability plan.

Broad new policy initiatives must be accompanied by increased vigilance to protect against criminal abuse that could undermine them. On April 6th, Secretary Geithner, along with Attorney General Holder, Secretary Donovan, FTC Chairman Leibowitz, and Illinois Attorney General Madigan announced a major inter-agency effort to combat foreclosure rescue scams. This included two specific FinCEN initiatives:

First, FinCEN issued an advisory with red flags to help financial institutions spot and report questionable schemes that may indicate a loan modification or foreclosure rescue scam.

Second, the Treasury Department announced an advanced targeting effort coordinated by FinCEN to combat fraudulent loan modification schemes. FinCEN is marshaling information from the financial industry and participating industries to identify possible loan modification fraud suspects, and to refer them to appropriate enforcement authorities for civil and criminal investigations.

By serving as a networking and deconfliction center, FinCEN is also helping law enforcement agencies streamline and coordinate their efforts. While Federal criminal investigators and prosecutors are committed to pursuing the most egregious organized criminal actors, it is critical that we involve our State and local partners to avoid letting criminals slip below the radar screen.

FinCEN can play a natural role here, through its relationships not only with all major Federal law enforcement agencies, but also FinCEN's longstanding support of law enforcement in all 50 States. Collectively, we must send a strong deterrence message to criminal opportunists tempted to prey upon struggling homeowners.

On behalf of the just-over-300 men and women of FinCEN, we are proud to play our part in supporting the Administration's and the Treasury Department's broader efforts under the financial stability plan, including the Making Home Affordable programs.

At least as important as our law enforcement efforts to hold criminals accountable, are efforts to prevent this illegal activity from happening in the first place. We can promote this goal by educating financial institutions and homeowners about risks and vulnerabilities and, where possible, using regulatory authorities to help mitigate risks.

Thank you for raising awareness of this important issue. I am happy to answer your questions.

[The prepared statement of Mr. Freis can be found on page 66 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Twohig?

STATEMENT OF PEGGY TWOHIG, ASSOCIATE DIRECTOR, DIVISION OF FINANCIAL PRACTICES, BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMMISSION (FTC)

Ms. TWOHIG. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, I am Peggy Twohig, Associate Director of the Division of Financial Practices at the Federal Trade Commission. I appreciate the opportunity to appear before you today to discuss the FTC's efforts to protect consumers from foreclosure rescue and loan modification scams.

With the rapid increase in mortgage delinquencies and foreclosures, the Commission has intensified its efforts to halt the proliferation of, and to warn consumers about, these types of scams. Today, I will briefly describe the FTC's recent law enforcement, consumer education, and policy development efforts to protect financially distressed homeowners from mortgage relief scams.

There are many varieties of mortgage relief scams. But, in most cases, the perpetrator makes misleading promises that they will be able to stop foreclosure or obtain a loan modification. These scams often share these characteristics.

First, they use terms like "guarantee," or "97 percent success rate," to mislead consumers about their chances of getting what the company is promising.

Second, they charge large up-front fees, as high as $1,000 to several thousand dollars for these promised services.

Third, after collecting the fee, they typically do little or nothing to help consumers obtain a loan modification or stop foreclosure.

Some of these companies use copycat names, or look-alike Web sites to appear to be affiliated with a nonprofit or government entity when, in fact, they are not. The Commission's latest case illustrates this tactic. The FTC alleged that the Federal Loan Modification Law Center misrepresented, through its advertising, that they were affiliated with or endorsed by the United States Government. The Commission also alleged that they misrepresented that they could obtain a loan modification or stop foreclosure in all or virtually all instances.

On April 24th, the court issued a preliminary injunction prohibiting the company from making misleading claims and collecting up-front fees. In a little over a year, the FTC has brought 11 cases targeting foreclosure rescue or loan modification scams. In our law enforcement program, we are working closely with other Federal agencies, such as FinCEN, as well as State law enforcers who are also actively pursuing these scams.

In addition to its recent enforcement actions, the Commission announced a new consumer outreach and education initiative to reach homeowners directly, with the help of other government agencies, nonprofit organizations, and mortgage industry members. Through this initiative, homeowners are receiving materials, such as this flyer, about how to spot and avoid mortgage rescue scams.

Most recently, the Commission provided mortgage servicers and others with an audio public service announcement from the FTC that they can use when consumers call. These announcements warn consumers about mortgage foreclosure scams, and provide tips on how to avoid them.

The FTC also will be considering what rules are warranted to more comprehensively protect consumers in this marketplace.

The Omnibus Appropriations Act of 2009 authorized the FTC to issue rules to prohibit unfair or deceptive practices with respect to mortgage loans. Using this new rule-making authority, the Commission intends to address unfair or deceptive practices by those selling mortgage loan modification or foreclosure rescue services. New Federal rules have the potential to greatly increase the protection the FTC can provide to financially distressed homeowners.

In conclusion, the Commission is committed to protecting consumers throughout the credit life cycle, including preventing harm to the many American consumers who struggle with mortgage debt. And the FTC is employing all of its tools—enforcement, consumer and business outreach, and policy development—to protect consumers from mortgage relief scams.

Thank you for the opportunity to testify at this hearing today.

[The prepared statement of Ms. Twohig can be found on page 104 of the appendix.]

Chairwoman WATERS. Thank you very much.

Ms. Coakley, Attorney General Coakley? Thank you.

STATEMENT OF THE HONORABLE MARTHA COAKLEY, ATTORNEY GENERAL, COMMONWEALTH OF MASSACHUSETTS

Ms. COAKLEY. Thank you. Good morning, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, my Federal colleagues here, this morning. I am Martha Coakley, and I serve as the attorney general of the Commonwealth of Massachusetts. I just want to note that my colleague in Florida, Attorney General McCollum, has been a leader on this issue, as have many of us at the State level, looking at the problems coming out of predatory lending.

I appreciate the opportunity to testify this morning on H.R. 1231, and the important issue of protecting homeowners from fraud related to specifically loan modification and foreclosure rescue.

While we have some concerns about H.R. 1231 as originally filed, we support the amendment offered by Congresswoman Gwen Moore, and we urge you to adopt it, so that consumers will be further protected from foreclosure rescue fraud.

Let me note that it has been apparent to me that there are few times when homeowners will be more desperate or more vulnerable than when they are facing losing their homes, or it has already occurred. In fact, it is the reverse of the American dream, and it has been most unfortunate, and it continues.

In Massachusetts, as in many parts of the country, we have experienced a dramatic surge in home mortgage foreclosures, due, in large measure, to unsound and predatory lending practices. Many foreclosures and delinquencies have resulted from loan practices and products that were, in fact, destined to fail, which is important to understand when you look at this crisis.

In response to this situation, our office has sought accountability through regulation under our powers under chapter 93(a), through litigation, and other advocacy, both with our fellow attorneys general and with Federal partners.

For instance, in June of 2007, our office enacted an emergency regulation under our chapter 93(a) for unfair and deceptive practices around foreclosure rescue schemes. We issued other regulations after hearing, but we felt that the issues around the kinds of schemes I'm going to discuss in a minute were so apparent that it was important to issue the emergency regulation.

In addition, we have brought litigation around and against attorneys, brokers, and loan modification assistance companies who have preyed upon homeowners facing foreclosure. We have brought suits against subprime lenders who promoted and originated risky

loans, and finally, against mortgage professionals who engaged in loan application fraud.

For instance, our office filed suit against two major subprime lenders, Fremont Investment and Loan, Fremont General, and H&R Block, owned by Option One Mortgage Corporation, for predatory lending practices. In Option One we also brought a claim that minority borrowers were targeted for subprime lending.

In both actions, we were able to obtain injunctions, injunctive relief, that restricted foreclosures on certain loans because of the specific combination of ultra-risky loan features and, most importantly, allowed us to essentially freeze those loans in time, so that they either had to be modified or come back before us before the holders were able to foreclose.

That has been our goal—in addition to enforcement, obviously—is to try to seek loan modification. So it is most disturbing to see the kinds of fraud that have arisen around those people who are already in trouble, and who, once again, are victims of predatory action. We have seen an increase in that. We think it will continue.

I want to just say we have seen two specific types of fraud. They include those who attempt to convince desperate homeowners to transfer ownership of their homes. That was really the first wave that we saw in 2006 and 2007, and really was our entree into looking at regulating predatory lending issues.

The second, which is what we see more frequently now, those who charge up-front fees with faulty promises to help homeowners obtain loan modification, often with little or no qualifications to do so, or ability to do so. That first scheme claims to assist consumers facing foreclosure by promising replacement mortgage financing. Owners would turn over title to their home. They would essentially become renters in their own home, but then couldn't pay the rent either, and would be evicted. So they would lose not only their home, their equity, and any chance of recovery.

More frequently, we have seen the fraudulent loan modification scheme that allows people, we believe, to make a quick profit by claiming to help consumers obtain loan modifications.

It has been apparent to us that by issuing these regulations in our State, it has allowed us to give quick and effective relief, particularly because these practices now are known to be illegal, and so we believe it has had a deterrent effect. And when it has not, we have been able to act quickly in court, by seeking injunctive relief, which is really what is necessary in these situations.

Particularly for the Federal legislation, we think that it will be effective to do it, and that Federal legislation will provide that kind of consistent Federal deterrent, as well as allow for State enforcement. The preemption issue is paramount for many of the attorneys general, and this allows us to continue to enforce our own State regulations, as well as this one.

We believe that many of the features of this would be very effective in the issues that we have seen. And so, we support it. We think it's particularly important that you not exempt brokers and attorneys. Many of the schemes that we have seen involved attorneys and brokers, and they are the very group of people who are most able to, frankly, unfairly and deceptively advertise and get business along these lines.

If I could make one other note, we would ask that you look at least at the allowable fees foreclosure cap. Our concern is that, in our experience for instance, that would allow, on the second prong, the sum of 2 monthly mortgage payments, as much as $6,000. We would observe that if a homeowner facing foreclosure is unable to make their monthly mortgage payments, or they're in imminent danger of falling behind, they will likewise be unable to afford 2 months' payment.

And indeed, we are concerned that cap might become a floor for what people would charge. So we just ask that you visit that.

We think it's crucial, as I mentioned, that States be allowed to bring these actions. We believe we have had success in Massachusetts in doing that. And we think that this trend of predatory loan foreclosure schemes will continue, but this would provide a very effective deterrent, and an effective way to enforce.

I appreciate today's opportunity, and we look forward to working with you, as I know my other colleagues do, on any other issues that arise around this legislation or this issue. Thank you.

[The prepared statement of Attorney General Coakley can be found on page 49 of the appendix.]

Chairwoman WATERS. Thank you very much. I will recognize myself for 5 minutes.

I thank you for coming today to give us testimony on this very important amendment that was offered by my colleague, Ms. Moore. And I think you can be very helpful to us in our strengthening this amendment to make sure that we accomplish what we would like to accomplish.

There are several things I would like to get a better handle on. Lawyers—as you know, lawyers are basically exempted in the amendment. And, because they are able to charge fees for their services not directly related to loan modifications, they are in the position of being able to offer services as any lawyer could offer various kinds of services on loan modification.

But I, too, have discovered that they are responsible for most of the problems we are having. I was in—I think it was—Detroit, Michigan, recently, where I learned about what some lawyers were doing.

And, of course, I have been paying a lot of attention to the Federal Loan Modification well-advertised program on TV, where I took the opportunity to call late one night, and made up a case for needing a loan modification. And, of course, they did what these fraudulent representatives do. After playing a little music, after hearing my story, they came back and told me how lucky I was that they would accept me for a loan modification, and asked me for $3,500.

These are the same people who had a blog that had me in the blog, having picked up some testimony that made it appear that I was supporting them. And then, of course, there is another blog with the President in it, making it look as if the President is supporting them. One is the United Law Group, and the other arrives from the Federal Home Loan Modification. I understand the founder of the Federal Loan Modification Group is a lawyer.

So, the question becomes, what do we do about lawyers? Some States have already exempted them. I attempted to offer a modi-

fication to Ms. Moore that was accepted that would deal with frivolous lawsuits, but I'm not so sure that covers it all. Do you have any thoughts about that? Let me start with FinCEN.

Mr. FREIS. Thank you, Madam Chairwoman. FinCEN has certainly seen, with respect to mortgage fraud problems more broadly, that insiders to the industry, including lawyers, have often been a part of the problem. I hope to say—and I believe it's true—that that's the exception, rather than the rule, that most lawyers do seek to serve their clients in productive ways. But I certainly agree with you, that certain lawyers have been bad apples.

But in terms of the aspect of how to exempt them, I defer to my colleagues who are responsible for the enforcement and the prosecution side with how it would affect them in the individual cases. But FinCEN does have broader familiarity with this issue under the aspect of our Bank Secretary Act regulations—

Chairwoman WATERS. No, I appreciate that. But I want to focus right in on lawyers and this amendment. This is an important amendment that could do a lot of good. We don't want to have a big loophole in here, though.

How do you feel about the exclusion of everybody who does not fit the qualifications that are being identified, Ms. Twohig?

Ms. TWOHIG. In terms of attorneys, as you noted yourself, one of the primary defendants in the Federal Loan Modification Law Center case that we have brought was an attorney. And so we have seen it firsthand in our law enforcement actions, that some attorneys are trying to use their bar license to basically set up shop as a mortgage relief company, and, in the process, we think—we have alleged—deceiving consumers about the services they are going to get.

So, I think, to the extent that there is any exemption for attorneys, it needs to be very narrowly drawn. They should not be able to exempt their telemarketers, the folks that you called when you called their number. There is no reason why those employees on the other end of the line should be exempt.

So, I think there could be ways to carve out a narrow exemption. Pro bono work likely should be carved out. But I think it needs to be very carefully considered, so that there is not a loophole that attorneys can drive through.

Chairwoman WATERS. Attorney General Coakley?

Ms. COAKLEY. We have considered that. And it's our belief that competent and ethical attorneys can be a valuable asset for homeowners trying to avoid foreclosure. Many people do employ attorneys for filing for bankruptcy, or representing them in connection with court proceedings.

But we have also found that many of the scams that we have investigated and prosecuted—for instance, one recently was called Loan Mods By Lawyers, and that was—that goes to the point that lawyers carry with them the authenticity that they will do this fairly and correctly.

I think the key is to stress that this does not prohibit, in Massachusetts, someone from taking a retainer, for instance, that then may be charged against services that are incurred—time incurred or other valuable service. What is concerning to us is that lawyers and others take a fee up front—$1,000, $1,500, as you indicated—

and that is an entry fee. That does not go to anything that's useful or beneficial.

Particularly when there are lots of nonprofits around to help people, people are getting more success now in trying to modify their own loans, that's the advice we give to folks.

We believe lawyers, frankly, would have a problem of their own if they continued to take these fees without providing services. And so we had no problem in Massachusetts saying, "We are going to declare for everybody that you cannot take a fee up front." It does not prohibit an ethical lawyer from, again, charging a retainer for which services afterwards could be charged against it.

But the fee for, frankly, no service involved, we have determined to be unfair and deceptive in Massachusetts.

Chairwoman WATERS. Thank you very much. Ms. Capito?

Mrs. CAPITO. Thank you, Madam Chairwoman. I want to start with the attorney general. I think you covered this in your statement, but I am curious to know.

For the States who have existing laws that deal with mortgage and foreclosure fraud on the books, and this particular bill, I think you stated that there isn't a conflict, and that your State statutes would still hold up, and the Federal statute wouldn't take over—could you explain that to me a little bit?

Ms. COAKLEY. My understanding is that this statute, unlike many other Federal statutes, does not preempt current State law, so that a State, for instance, that had higher measures or higher standards around this could still enforce those.

I think the nice piece of this is that these standards, though, will be consistent across the States so that they can be enforced either by the Federal Government or, in a State, for instance, where there has not been legislation passed, an attorney general could enforce this in a way—again, particularly in this area, I think we would have a huge deterrent effect on this activity.

And so, we see it as a complement to Federal legislation. It's not duplicative, and it does not disadvantage the States by preempting us from the field.

Mrs. CAPITO. All right. Thank you. Just an informational question. With these—are you finding in your investigations of—or when you're bringing suit, that a lot of these fraudulent scam artists—we will put it that way—are they national in nature? Are they targeted in, let's say, Florida or Massachusetts or Nevada or California? You know, what's the nature of that?

And my additional question is, we know that this exists. Just for my information, are there legitimate businesses that actually carry forth this business of helping people prevent foreclosure that exist throughout the country? I'm sure people have assistances, but are there businesses created just for this?

Ms. TWOHIG. I can take that one. Starting with your first question, clearly some of these companies are national. The Federal Loan Modification Law Center had nationwide advertising on TV, radio, and the Internet. And they were nationwide.

Some are not. Some are more local in nature. I think, in the old days, we used to see people knocking on doors, literally going door-to-door. I think more often now they are using the Internet and telemarketing and telephones to reach out more broadly. And I

think what is true is almost always they are clearly crossing State lines. So, that's the picture that we see.

And, in terms of—your second question?

Mrs. CAPITO. Are there legitimate businesses—

Ms. TWOHIG. Oh—

Mrs. CAPITO. —created on a national level, more interestingly, that are playing by the rules, although there are really no rules for this?

Ms. TWOHIG. I think that's a hard one for—from the Federal Trade Commission's perspective, to answer. Because, of course, we zone in on the ones we think are problems. And so, we see the bad practices and the bad actors. We spend our time there. And so, from what we see, we see very troubling practices.

I will say, though, that there are some things that no one can legitimately promise. No one can guarantee that you will get a loan modification. No one can guarantee that they will stop a foreclosure. So no one can legitimately do that. That's just not possible, to promise that.

Mrs. CAPITO. Mr. Freis?

Mr. FREIS. Ranking Member Capito, if I can add, in response to your first question about the national nature, first it must be said that we have seen schemes that cross the entire country, from California to Massachusetts, from Washington State to Florida, and multiple places in between.

With respect to the targeting effort that we have ramped up in the past month, one of the successes that we have had, on an initial basis, is the ability to bring together the attorneys general from different States with respect to specific actors that are operating in multiple States. And, more broadly, with respect to the mortgage fraud issue that we have been focusing on for years, we do indeed see national organized criminal groups.

Mrs. CAPITO. Just in closing, I would like to reiterate something the attorney general said, that—and we have had this in our committee several times, trying to get, you know, help for homeowners, and all the assistance to help people really figure their way out of this problem. There are a lot of great nonprofits all across this country that are daily trying to help folks figure out a way to stay in their home and keep their home.

And, additionally, I would say that if there is anybody out there who has an 800 number that advertises, the chairwoman will be calling you on one of her sleepless nights, because she always has them on speed dial, I think. So I yield back. Thank you.

Chairwoman WATERS. Thank you. Mr. Lynch.

Mr. LYNCH. Thank you, Madam Chairwoman. I want to thank you for holding this important hearing. And also, I want to thank our witnesses, especially my own attorney general from the State of Massachusetts, Martha Coakley. I appreciate the work that you have been doing on this, all of you.

A while back, in my district, the Town of Randolph was kind enough to give me the high school auditorium, and we did a foreclosure prevention workshop. We expected maybe 100 people to show up. We had over 400 families coming in.

And the one thing that I did like was the fact that we had already vetted a group of banks, mortgage companies, and non-

profits, to come in and help with these work-outs. Would that type of model—you know, if we had—and I know in Massachusetts, we have—at least in Brockton—we have some good groups that are nonprofits that are working to help families out of this, and to work with banks to get these modifications accomplished.

Is there a way that we might intervene, do these town meetings, bring in the legitimate folks to conduct these, or assist with these modifications the way they should be done, as opposed to just trying to fly the red flag about, "These are the guys you need to watch out for?"

Ms. COAKLEY. If I can answer that, I think they are not mutually exclusive, and I think they complement each other. On the one hand, you need to make those folks who need help aware of what the resources are. And I know we do that through our Web site. I know there are lots of other organizations that have tried to do that, bar associations that do volunteer work.

But it still is the individual who doesn't pay attention to that until they get the notice in the mail, and then they panic, and then they're going to be victimized, potentially, by one of these e-mails, faxes, telephone calls.

And I agree with the assessment. They are national, but there are also very local ones.

Mr. LYNCH. Yes.

Ms. COAKLEY. Our first case was against an individual in one of our communities who, frankly, preyed upon his neighbors and friends and church members, and took all the titles to their homes. And it was pretty discouraging to see that happen.

Obviously, with the economy, and with brokers out of work, and attorneys looking, this is a scam that can be lucrative with quick hits on the small level and on the national level.

So, I think we need to continue to advise people of how they can get loan modifications, and banks have been a little better about trying to do that without help. But with not-for-profits available, that is the route to go. And for someone to say, "I can guarantee you that I will help you modify your loan," it's too good to be true, so it isn't.

Mr. LYNCH. Right. Mr. Freis, yes?

Mr. FREIS. I concur with the attorney general, that the education aspect is critical, and must underscore the Administration's commitment as part of the Making Home Affordable program to promote the work of financial institutions to help homeowners who have a legitimate ability to modify their loan.

But, of course, bringing in—some of the banks only get part of the parties involved. You need to ultimately bring in the servicers with respect to the individual homeowner's loan. And, once again, I think that needs to be a national effort. We know that the mortgage market is no longer just on a local basis.

Mr. LYNCH. Director, let me ask you. I work with FinCEN a lot, as you know. We just worked on opening the financial intelligence unit in Morocco about 3 weeks ago. It's tough to get my head around the fact that you're dealing with all that, you know, anti-terrorist financing—I happen to co-chair the task force on terrorist financing and non-proliferation—and you're also doing this.

I can only imagine the volume of suspicious activity reports and cash transaction reports that you're getting from banks under the Bank Secrecy Act and all the other statutes that are steering information through your office. And now you're dealing with this, which is more generic and home-grown—insidious, nonetheless.

But how are you handling it, as an Agency within Treasury? How are you handling the responsibility of screening all this? And is this something that is coming to you regularly? And how do you deal with that, from a workload perspective?

Mr. FREIS. Congressman Lynch, first let me thank you. You have been a great supporter of FinCEN, and in particular in reintroducing the Reauthorization Act. We appreciate that ongoing support for all of the work that we do.

Basically, with respect to your question, it's true. FinCEN is a very small agency of a little over 300 persons with a broad mandate. And, basically, it's all about following the money. Criminals, they don't respect the law. They certainly don't respect the borders.

So, one unique authority that Congress has given us is the ability to go beyond the jurisdictional limits that constrain some of the work of our law enforcement partners, and to reach out to our counterpart agencies around the world. Exactly as you mentioned, the financial intelligence units, now we have relationships with more than 100 countries.

So, in the past, when a criminal sent money abroad—and we have seen multiple instances, including those suspects involved in mortgage fraud who have shuttled money out of the country, that's detailed in the March 2009 report that we published—we have the ability to reach out to our counterpart agency and not lose that trail.

In other cases, agencies literally—they give up. They say, "It gets too hard for us to follow the money when it leaves the country," and we have an ability to extend that effort along the continuum.

In terms of the resource issue, focusing on domestic fraud has been a core part of FinCEN's mission from its very inception. And, next to all the work that we're doing with respect to mortgage fraud, loan modification schemes, and the like, the next biggest area where we're working on is the southwest border and Mexico-related threats from the homeland.

Chairwoman WATERS. Thank you very much. Mr. Driehaus?

Mr. DRIEHAUS. Thank you, Madam Chairwoman, and thank you very much for conducting this hearing on, as Mr. Lynch indicated, a very important matter. And I want to thank Ms. Moore for her efforts in this area, as well.

As I have heard each of you testify, and read your testimony, I am pleased with the fact that we are moving in the right direction, in terms of cracking down on some of these fraudulent schemes. But I continue to be very concerned about local enforcement, and the resources going into local enforcement.

You know, for years, we have seen these predatory activities. And even when we knew that fraud was occurring, and prosecution could take place under existing State law, it didn't happen. And it didn't happen, in many cases, because it was either not on the radar screen of the attorneys general and the various States that we represent—I happen to be from Ohio—and certainly it wasn't

on the radar screen of local county prosecutors who are worried about robberies and murders, and things of that nature.

How do we—you know, in your experience, how do we better help local prosecutors and attorneys general to become aware of the issues regarding mortgage fraud? And how do we get them the needed resources? And what types of resources do you think they need in order to fully investigate and prosecute this type of behavior?

I appreciate the testimony, Ms. Coakley, about what you are doing, and what some of your colleagues are doing in the various States, but I would like your opinion on whether or not we're going nearly far enough, given the scope of the problem.

Ms. COAKLEY. I think in this particular area, which is limited appropriately to these kinds of frauds, I think this is—in fact, goes far enough, and will be very helpful.

In general—and it's a bigger issue than I think we can address today—many of the State attorneys general have been held back because they specifically have been preempted from taking action for banks and other areas. So we have, in beginning this effort, been limited to those companies over which we had jurisdiction, and weren't preempted from.

For instance, we have no ability to look at credit card interest rates, because we're totally preempted from that. So I just use that as an example.

We could always use more resources. Everybody could in Massachusetts. It is the DAs who, as you indicated, do the violent crime. We try to focus on both civil and criminal, these kinds of issues.

But I guess I feel that this particular problem was one that caught everyone on Wall Street, Main Street, Elm Street, AG's office, Federal level, we all kind of saw it coming, but we didn't. And, to the extent that we are able to start to identify pieces of it, we did what we could where we were not preempted.

And I would just ask for this committee, as we go forward, to look at this model and this bill, which says, "We're not going to preempt States, we want a consistent model. We will let States enforce the Federal model," which I think is a workable way to go about this issue. But we are the ones who do see these problems first. They start out small, often, and we see them, in some States and not in others, well before they reach the level that Washington can respond to them.

And it is incredibly important, I think, as the AGs have worked together on many of these issues, that we can—and I am hopeful that we will—work more closely with the Federal Government in ways that do not duplicate these kinds of actions, that we have consistent standards for those that we are going to regulate, and that we complement both the deterrent effect that the legislation or regulations have, and our ability to enforce violations of them.

Mr. FREIS. Congressman, certainly we see every day the resource limitations that the State and locals have, in terms of going forward with enforcement actions, particularly in this economic environment.

But I think one of the critical things that we can do—and what FinCEN has always tried to do—is serve a multiplier effect in leveraging resources. We do that in a number of ways.

We have relationships in every State, with the State law enforcement coordinator, such as the Massachusetts State Police Department which operates a fusion center, together with other local entities in Massachusetts. We provide them with information, and we provide them with leads in areas such as this, with respect to loan modification fraud.

Another thing that we actively do is try to share expertise. We go out there and we train them as to what are the modus operandi that the criminals are following, and what are some of the successful ways we have been able to do that in law enforcement.

Basically, what we're trying to do is move away from the compartmented model so that every single field office, every single State entity, has to reinvent the wheel with a recurring problem. I think that has been very successful. We would like to do more. And, with respect to this effort in particular, we have established relationships with 38 States' attorneys general. Every one of those is multiplying and building off of successes of one another.

Chairwoman WATERS. Thank you very much. Mr. Ellison?

Mr. ELLISON. Thank you, Madam Chairwoman, for this very important hearing. I appreciate it. As usual, you are leading the way.

Ms. Twohig, how would H.R. 1231 enhance the FTC's enforcement powers with respect to stopping these fraudulent actions?

Ms. TWOHIG. I think what it would do would establish some Federal standards, some Federal rules of the road, if you will, that would help us protect consumers. Without that, we are using the tools we have now, which is primarily the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices. And that is what we are using to go in and charge the companies with deceptive practices when they promise things that they can't deliver to consumers, a loan modification or rescuing them from foreclosure.

But, with that said, it would be helpful, in my view, to have some standards in place that would outline exactly where the lines are, what's legal, what's not, and to rein in and prevent some of the practices, such as the taking fees up front.

Mr. ELLISON. Does the FTC have adequate staff to carry out the new clarifying powers that it would have?

Ms. TWOHIG. We have stepped up our efforts in this area considerably, both enforcement—and we have new authority under the Omnibus Appropriations Act to do rule-making with respect to mortgage loans. So the Commission has said it intends to use that authority to also see what it can do under that authority to put some rules in place.

Mr. ELLISON. Do you have enough staff?

Ms. TWOHIG. Yes.

Mr. ELLISON. Would the FTC essentially do the investigative work, and then refer the case for prosecution to the U.S. Attorney?

Ms. TWOHIG. The cases we do we bring ourselves—

Mr. ELLISON. Okay.

Ms. TWOHIG. —in Federal court. We have to refer to the Department of Justice if we are seeking civil penalties under a particular statute. But under the Federal Trade Commission Act, we file the suit in the name of the Federal Trade Commission directly, ourselves, in Federal court.

Mr. ELLISON. Okay. So, for the cases that you might refer to Justice, in your view, do you have any view on whether they're adequately staffed to handle the cases you might refer to them?

Ms. TWOHIG. Well, right now, in this area we are bringing them under the Federal Trade Commission Act. So right now, that's not an issue in this area.

Mr. ELLISON. Okay. One of the issues that has come up quite a bit—well, let me ask you this. In your written testimony you state that the FTC has rule-making authority to prohibit unfair and deceptive practices with respect to mortgage loans, and is working on a rule to restrict foreclosure consultants.

What is the FTC's progress on the rule? And when will a proposed rule be issued?

Ms. TWOHIG. We just got that authority recently in the Omnibus Appropriations Act, and so we are currently busily formulating a recommendation to make to the Commission, which would get that rule-making process started. We expect that to be very soon.

Mr. ELLISON. You know, in some of my conversations in my own district in Minneapolis and the surrounding suburbs, we have heard people complain about high re-default rates after there has been a loan modification. How is this foreclosure prevention fraud related to re-defaults? Or is it?

Ms. TWOHIG. I think it's really two separate issues. The issue that we have been focusing on, that the testimony focuses on, is the segment of the market place as trying to prey on consumers—

Mr. ELLISON. Right.

Ms. TWOHIG. —who are desperate, in desperate straits, and reaching out for an answer, and they are falling victim to the companies that are promising them something they just can't promise.

Mr. ELLISON. I understand.

Ms. TWOHIG. I think a whole separate issue is when the mortgage servicers themselves and the legitimate nonprofit sector are obtaining actual modifications for consumers, and whether—what the standards are there, and whether they're actually succeeding.

Mr. ELLISON. So these companies engaging in fraud are not setting people up to re-default?

Ms. TWOHIG. Mostly, from what we have seen, they're not getting their modifications at all.

Mr. ELLISON. Okay, I got it.

Ms. TWOHIG. Exactly.

Ms. COAKLEY. I agree with that, that they have been totally ineffective in any way, so they are not—the re-default loan rate is due to something else.

Mr. ELLISON. They don't even get to re-default, because they never even get the modification.

Ms. TWOHIG. Right.

Ms. COAKLEY. Correct.

Mr. ELLISON. All right. I think that is all of my questions, Madam Chairwoman. Thank you very much.

Chairwoman WATERS. Thank you very much. Without objection, Representative Moore will be considered a member of this subcommittee for the duration of this hearing, and we thank Ms. Moore for her amendment and the work that she has done. And I will recognize Ms. Moore for questions.

Ms. MOORE OF WISCONSIN. Thank you so much, Congresswoman Waters. And you promised me early on that, even though I'm not a member of this subcommittee, that you would honor me when I came. And I thank you so much.

I do want to thank Congresswoman Waters publicly for all of the work that she has done on this. California, of course, has—they passed a law back in 1979 with respect to mortgage fraud problems. Were you in the State legislature then, in 1979?

Chairwoman WATERS. Yes, I was there.

Ms. MOORE OF WISCONSIN. Yes. And so I appreciate all of the sage experience that she has had. And, of course, being the subcommittee chair, she has worked very closely with me on this issue of exemptions, in particular, for attorneys. And given her 2½ hour long vigils on the phone, she has really been a point person, and known up front the toxicity of this problem.

And I can tell you that, while this has been a problem all along, with the mortgage meltdown this has just created an environment where there has been an 800 percent increase. So I appreciate questions like the one Mr. Ellison has made, with respect to whether or not there are enough resources to do that.

And I might just add, knowing that I am consuming my time, Madam Chairwoman, but what I continue to hear is that legitimate help, like with the HUD-sponsored counseling, homeowners counseling, it's very, very underfunded. And perhaps that's an avenue for putting a lot of these folks out of business, to make sure that we take seriously—when I bought my first home, I had a certified HUD counselor, and I just took that for granted, that people would have those kinds of services available to them.

I also want to thank Ms. Twohig from the FTC for helping us work on developing this bill, and appreciate your having stepped up.

Now, let me ask some questions. Ms. Twohig, the authority that you have gotten through the omnibus with respect to mortgage fraud, is that for just non-banking institutions, or for all financial institutions?

Ms. TWOHIG. It—

Ms. MOORE OF WISCONSIN. Because I noticed in your testimony that you were recommending that you have power over, you know, banking mortgage, as well as the—your current stewardship over non-banking activity.

Ms. TWOHIG. Right now, the authority we would have would be the same authority we have under the FTC Act, which is non-bank entities. So, under the FTC Act, we do not have authority over banks.

In this area, however, I would say that the foreclosure rescue and loan modification services that we're concerned about, the ones that are taking advantage of consumers, are in the non-bank sector. So we believe we can cover pretty much what needs to be covered there.

Ms. MOORE OF WISCONSIN. Okay. I am only asking that because I noticed in your testimony that you were seeking authority over all financial institutions, and I was wondering if you thought that that was important toward ending this activity, or was that just a suggestion for some other point.

Ms. TWOHIG. Right. I think what you're referring to is the Commission's views that, in the larger scheme of things, when it comes to broader-based financial services regulatory reform, that if those issues are considered and a new agency is thought to be needed, that the Commission be considered and consulted in that calculation.

On this area, I think it's—as I said, I think we could basically cover what needs to be covered with our jurisdiction because it's non-banking entities that are taking advantage of consumers.

Ms. MOORE OF WISCONSIN. Okay. Ms. Coakley, I believe that you spoke to us about the caps on fees. And I guess I—you said that 1 percent or 2 monthly payments would be too much.

And so, I was wondering, number one, what you thought would be appropriate. And I also would like—because I see my time is expiring—you to make a little bit more clarification about the exemption for attorney's fees. And, you know, what—the problem we ran into in trying to craft a perfect amendment is that we don't want to stop attorneys from helping people with legitimate work regarding, you know filing for bankruptcy, and so on.

And so, please—Madam Chairwoman, with your indulgence, can she answer?

Chairwoman WATERS. Yes.

Ms. MOORE OF WISCONSIN. Thank you.

Ms. COAKLEY. Let me answer it this way, because we agree with you. We want attorneys who do the work who are qualified—and people certainly are entitled to engage attorneys for that work.

But attorneys have a way in which they either bill their time or enter into a contingency fee agreement. This is neither of those. This is an up-front fee, basically as an entry fee that doesn't go towards the result.

And so, we firmly believe—and, frankly, when we issued this regulation, we did not hear from the bar. We did not have problems that lawyers felt that this was unfair, because we think that those who are competent and ethical and who do play by the rules—and, again, they can take a retainer if the party agrees and the lawyer agrees. But the retainer has to then be counted against time that the attorney has spent on the process, as he or she would bill any client for work done.

Ms. MOORE OF WISCONSIN. So the question is—okay, like I'm thinking now—what we want to do is regulate the relationship between the attorney and non-lawyers. So if I am a delivery service delivering stuff to the court because I'm filing some papers, the attorney might need to pay me to do—

Ms. COAKLEY. Correct.

Ms. MOORE OF WISCONSIN. —to that. So, what we're trying to do is regulate that relationship without stopping the attorney from doing it.

So, we do need help in the rule-making process, Ms. Twohig, to narrow it, as you suggested it, but still keep the normal—Madam Chairwoman—legal relationships intact. And just, very quickly, the other question that I asked, about the caps?

Ms. COAKLEY. Oh. I talked with our folks yesterday about this, because our experience, at least in Massachusetts, and it may differ in other States, is that these fees have been around, you know,

$1,000, $1,500. But with this cap, it could be as high as $6,000. We think that second prong, 2 months of a payment, would essentially become a floor that people would start to charge.

And so, I'm afraid I don't have an absolute, but just to consider whether there may be a lower cap, in terms of a dollar amount or a percentage. And I would assume my colleague may be able to help with that, also. But that seemed high to us, given our experience in the field.

Ms. MOORE OF WISCONSIN. Okay. Thank you. Thank you so much. My time has expired. I would love to continue, but I don't want to get gaveled.

Chairwoman WATERS. Thank you.

Ms. MOORE OF WISCONSIN. You have been very generous, Madam Chairwoman.

Chairwoman WATERS. Thank you very much. And let me thank my witnesses, particularly the attorney general, who has done so much work in Massachusetts on this. And, of course, the Federal Trade Commission that we have turned to, and you have been very effective in shutting something down.

But we want to remind you that the blog, KeepmyHouse.com, is still up, even though the Federal Loan Modification Web site is not connected to it any more. So stay on top of them. And we are going to do everything we can, working with Ms. Moore, to give you more help.

Thank you all very much for being here today. We will get our second panel up. The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place their responses in the record. Again, I dismiss this panel and call on our second panel.

Our first witness will be Ms. Lauren Saunders, managing attorney at the National Consumer Law Center.

Our second witness will be Mr. Scott Drexel, chief trial counsel at the State Bar of California.

Our third witness will be Mr. Robert E. Story, chairman elect at the Mortgage Bankers Association.

And our fourth witness will be Mr. John Anderson, vice chair of the Federal Housing Policy Committee at the National Association of Realtors.

Without objection, your written statements will be made a part of the record. And I will recognize each of you for 5 minutes, beginning with Ms. Saunders.

Thank you for being here.

STATEMENT OF LAUREN SAUNDERS, MANAGING ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. I appreciate the opportunity to testify before you today.

Yesterday's home equity strippers have become today's loan modification specialists, charging thousands of dollars for work, if any, that often leads nowhere and leaves the homeowner closer

than ever to foreclosure. Lead generators are selling the names of homeowners who are 30, 60, or 90 days late, to loan mod mills.

Firms are springing up from and recruiting among the ranks of the same people who were offering subprime loans and no doc loans of the type that led us into this crisis. The primary qualification for the jobs that are being advertised on the Internet seems to be the ability to "close," the ability to pressure a reluctant homeowner into agreeing to the contract.

Many of the loan mod firms are outright crooks, who have no intention of doing anything. But others are operating in a gray zone, perhaps making some unsuccessful efforts to contact the lender. But, from the homeowner's perspective, there is really no difference between a crook who takes the money and runs and somebody else who says, "Sorry, I tried, but you can't have your money back."

The sheer number of people in foreclosure is an obvious attraction to the scammers. But loan mod scams are flourishing because, as the chairwoman well knows, servicers have been unresponsive, and homeowners are not able to get loan modifications directly.

I will get to the scams in a moment, but I would be remiss if I didn't point out that the most important work that Congress can do to prevent these scams is to attack the servicing problem, as the—the chairwoman, of course, has been a lead on this issue, and to mandate access to a decision-maker at the servicer, somebody who has the information and authority to actually deal with the loan modification, and to require that the servicers engage in loss mitigation efforts before they foreclose. People are going to these middlemen because they can't do it directly. And if they could do it directly, I think a lot of this would go away.

Regarding the scams themselves, many States have been active in passing laws to address them. Others have been slower. As long as stronger State laws are not preempted, as they are not under this bill, Federal legislation can be helpful, as long as it creates strong, substantive protection, as H.R. 1231 does, and not just disclosure hoops for scammers to jump through. Any law or rule will do more harm than good if it simply is sanitizing the Web sites, but allowing the operations to continue.

Effective legislation should prohibit up-front payments for foreclosure consultants. And, setting aside the lawyers for a moment, I think that should include taking money and putting it in escrow, but then charging against it.

Second, it should require results. The fee should not be earned unless and until the homeowners receive an affordable, sustainable loan modification, and that gets to, I think, Congressman Ellison's point about the re-defaults. A loan mod that increases your payments isn't worth paying for.

The level of the fees should be tied to the results achieved. And I agree with the concerns about the 2-month standard as being too high. I would urge that you look to Illinois, which has capped the fees at 50 percent of the monthly payment, unless the modification results in a reduction for 5 years, in which case it can go up to 100 percent, a full month.

And we need to avoid unnecessary exemptions that open wide loopholes. I don't think legitimate mortgage brokers and real estate brokers need an exception for advance fees, because they're not

normally paid until they sell a house or obtain a mortgage. But if they're operating outside of the scope of their traditional activities, the mere fact that they possess a license should not insulate them.

Lawyers are a trickier case. I fully recognize that lawyers are part of the problem. I support the efforts of the FTC to crack down on those lawyers who are engaged in deceptive conduct. But I am concerned that we not go too far in stopping the work of the frontline people who are actually helping the homeowners who are confronted with foreclosure rescue scams, or predatory mortgages.

I note that Attorney General Coakley interprets her regulation to permit a retainer. But we don't want that loose standard to infect the rest of the bill as well. My own office offers a paid consulting service, even though we're a nonprofit, where other lawyers can pay us to review loan documents and advise on claims. Certainly, legitimate lawyers may send a demand letter and engage in activities short of litigation, and they should be able to charge for those.

So, on the other hand, we do want to crack down on the lawyers who are offering the cloak of their license to shield the work of nonlawyers, whether it is a loan mod firm that contracts with an attorney, or an attorney who is running a large mill operation which really has nothing to do with the practice of law.

To the extent that the FTC adopts rules in this area, we think it's essential that they use their unfairness authority to ban up front fees and fees with no results, and not merely its deception authority to require disclosures or sanitize Web sites.

Finally, Congress does need to increase funding for the HUD-approved counseling agencies which are really the best next step, after the servicer themselves, to get homeowners the help they need.

Thank you for inviting me to testify, and I welcome your questions.

[The prepared statement of Ms. Saunders can be found on page 75 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Scott Drexel?

STATEMENT OF SCOTT J. DREXEL, CHIEF TRIAL COUNSEL, THE STATE BAR OF CALIFORNIA

Mr. DREXEL. Thank you, Madam Chairwoman, Ranking Member Capito, and members of the subcommittee. I am the chief trial counsel of the State Bar of California. California has a total of more than 225,000 attorneys, more than 165,000 are whom are active members and entitled to practice law in our State. Approximately 1 of every 7 attorneys in the United States is a California attorney. My office is responsible for the investigation of complaints against California attorneys, and for the disciplinary prosecution of those attorneys who have violated our rules of professional conduct or our State Bar Act.

Since approximately November 2008, we have received an average of more than 900 telephone calls per month to our 1–800 complaint line, an annual rate of more than 10,000 telephone calls, on the subject of mortgage foreclosure scams and loan modification scams alone. Clearly, this is a problem of significant, if not crisis, proportions in California.

The problem is so serious that in February 2009, our committee on professional responsibility and conduct issued an ethics alert to all California attorneys and to the public about the dangers of loan modification and foreclosure rescue fraud, warning attorneys about the possible ethical implications of their involvement in these sorts of activities.

In response to the large number of written complaints received by my office on this subject, we have created a staff task force to focus solely on complaints of foreclosure rescue and loan modification fraud. We are working extensively with other agencies to address the issues, especially the California Department of Real Estate, which regulates mortgage foreclosure consultants in California.

We have tried to be proactive in our response to suspected involvement of California attorneys in this area. Pursuant to our statutory authorization in March 2009, we successfully petitioned a California superior court to assume jurisdiction over the practice of a California attorney who was engaged in loan modification fraud.

Pursuant to court order, and with the assistance of local law enforcement, we seized more than 2,300 of the attorney's files, downloaded records from his computers, froze his bank accounts, both his client trust account and office accounts, and redirected his telephones and mails to the State Bar offices. We are in the process of returning files and advance fees to the attorney's clients, and assisting them in obtaining services from legitimate practitioners.

We have also attacked the accuracy and propriety of advertisements by attorneys in this area. Under our rules of professional conduct, attorneys are prohibited from making false, misleading, or deceptive statements in advertisements, and can neither guarantee success nor advertise past successes without appropriate disclaimers.

We have, therefore, been demanding copies of the attorneys' advertising, and demanding documentation to substantiate the claims made in their advertising. Our goal is to force the removal of all false and misleading advertisements from the media, thereby making it more difficult for these unethical practitioners to prey upon members of the consuming public.

We have initiated more than 175 active investigations of attorneys suspected of engaging in these activities. And we are especially targeting those practitioners against whom we have received multiple complaints, or who appear to be particularly egregious in their victimization of consumers.

Tomorrow morning, in Los Angeles, I will be meeting with representatives of the United States Attorney's Office, the California Attorney General's Office, the Department of Housing and Urban Development, the Federal Trade Commission, the Department of Real Estate, and local DA representatives to work cooperatively and to try to develop a plan for attacking these loan modification and fraud schemes in our State.

H.R. 1231, in my opinion, will provide significant assistance in preventing foreclosure rescue fraud by prohibiting foreclosure consultants from demanding or receiving advance payments from homeowners, and by requiring loan services to notify homeowners

of the dangers of these fraudulent activities, and to direct them to the Department of Housing and Urban Development and others for instance in avoiding foreclosure.

H.R. 1231 currently excludes attorneys, as does our California statute. California, as Representative Moore has indicated, has had regulated mortgage foreclosure consultants since 1979. However, attorneys are excluded from the definition of a mortgage foreclosure consultant.

Currently in California, there is pending a bill, Senate Bill 94, which would extend the prohibition upon advance fees to attorneys, as well as to others. The board of governors of the State Bar will be considering, next week at their meeting, whether they support or oppose that legislation. However, as an independent prosecutor, I have already gone on record as supporting that measure and that limitation upon attorneys' fees.

Attorney fees in California are regulated in other areas, in medical malpractice actions. Attorneys' fees are limited by statute. In workers compensation, probate proceedings and the like, attorneys' fees are regulated. I see no reason why they cannot and should not be regulated here. Therefore, I personally support Representative Moore's proposed amendment.

And again, I thank you for the opportunity to appear today.

[The prepared statement of Mr. Drexel can be found on page 57 of the appendix.]

Chairwoman WATERS. Thank you very much.

Mr. Robert Story?

STATEMENT OF ROBERT E. STORY, JR., CHAIRMAN-ELECT, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. STORY. Chairwoman Waters, Ranking Member Capito, and members of the subcommittee, thank you for inviting me and the Mortgage Bankers Association to discuss the very important issue of foreclosure rescue scams.

I am here today because MBA shares your concerns about the rapid rise in these scams. There is no doubt we need to protect innocent homeowners. Those committing fraud prey on people at the end of their financial rope. Their scams start with a phone call, a mailing, or an advertisement promising help. These scammers are difficult to distinguish from organizations offering real help. They even use similar names. They are all designed to achieve one thing, and one thing only, to lure the person who is desperate for help.

When a fraudster makes contact, the borrower is told that their situation is dire, and they are going to lose their home. The scammer does everything possible to raise the anxiety level of the borrower. When the borrower is at their lowest point, the scammer says, "There may be a solution." But the solution comes with a price. The borrower must agree to cooperate, and the borrower is told to cease any communication with their lender, to avoid being detected.

These scams take many forms. Scammers promise to complete paperwork and obtain a loan workout in exchange for fees that can escalate into thousands of dollars. Then the scammers either don't follow through, or perform menial tasks that a servicer or HUD-approved counselor could complete for free.

Scammers convince homeowners that they can save their homes from foreclosure through deed transfers and promises to lease or sell back the property, which never happens. In extreme instances, scammers sell a home or secure a second loan without the homeowner's knowledge, stripping the property's equity for personal gain.

So, what can be done to stop these cruel practices? First and foremost, borrowers need to turn to the right sources for help. MBA encourages borrowers in financial trouble to call their mortgage servicer right away. Mortgage servicers want to avoid foreclosure. They have an economic incentive to do so. Servicers have the legal authority to create repayment plans, refinance, or modify a mortgage. Borrowers should contact trustworthy sources for advice and counseling. The HOPE Hotline at 1–888–995–HOPE, or a HUD-approved counselor are trustworthy resources. State and local governments across the country have also set up hotlines.

Raising consumer awareness of scams is a vital function of government and industry efforts. The Treasury Department and banking regulators have issued alerts for consumers. And the FTC has produced a fact sheet warning consumers about servicers that promise to stop the foreclosure process.

We also need to redouble our efforts to go after those who prey upon vulnerable homeowners. The legal tools needed to investigate and prosecute fraud are already in place. The Federal mail and wire fraud laws reach all possible varieties of foreclosure rescue fraud. What's missing are the resources.

MBA has asked Congress to appropriate additional funding for the FBI to investigate and prosecute fraud. The funding will pay for new FBI field investigators. It would also allow the Justice Department to hire additional prosecutors focused on this area. The funding would also support the operations of the FBI inter-agency task force in the 15 areas with the worst problems.

MBA is particularly pleased that today the House is taking up S. 386, the Fraud Enforcement and Recovery Act. This bill includes $245 million for law enforcement to crack down on financial fraud, including foreclosure rescue fraud.

On behalf of the MBA, I would like to thank the subcommittee for the opportunity to testify today. Foreclosure rescue fraud is a growing problem that is becoming more expensive for homeowners and lenders. MBA believes increased enforcement, better communication, and further innovation are required to adequate protect borrowers from the cost of foreclosure rescue fraud. Thank you.

[The prepared statement of Mr. Story can be found on page 98 of the appendix.]

Chairwoman WATERS. Thank you very much. Mr. Ellison, will you introduce our next witness?

Mr. ELLISON. Thank you, Madam Chairwoman. Madam Chairwoman, members, John Anderson has been a licensed Realtor with Twin Oaks Realty in Crystal, Minnesota, as a sales person and broker since 1980. He is the present owner of the family business started by his father in 1961. John has assisted and counseled thousands of buyers and sellers over the years as, primarily, a residential broker. He has also been active in the industry, serving as

a volunteer on national, State, and local levels of the Realtors Association.

One of his key interests, because of his personal involvement, has been in the area of government financing, specifically FHA/VA mortgages, and their importance to the customer. He has been recognized as Realtor of the Year on both local and State levels, and has been named as "Super Real Estate Agent," by Minneapolis St. Paul Magazine every year since 2003. He is married and has three children. Thank you, and welcome.

STATEMENT OF JOHN W. ANDERSON, VICE CHAIR, FEDERAL HOUSING POLICY COMMITTEE, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. ANDERSON. Thank you, Representative Ellison. Thank you, Chairwoman Waters, Ranking Member Capito, and members of the subcommittee. I want to thank you for the opportunity to testify today on foreclosure rescue scams and the need for mortgage reform. I am testifying on behalf of NAR's 1.2 million members. I can tell you firsthand that the more lending abuses we see, the higher the prevalence of foreclosures. Foreclosures are like mold; once they start, it's difficult to get rid of them. Foreclosures lead to families losing their homes, as well as their savings, and can cause all homes in a neighborhood to lose value.

Foreclosure rescue scams and loan modification scams are becoming more and more prevalent. One of the most pervasive foreclosure rescue scams that I have seen is the reconveyance. In this situation, a so-called foreclosure counselor tells a homeowner that, in exchange for paying the mortgage debt, the homeowner will sign a quit-claim deed, and can remain in the house as a renter.

The scammer says the homeowner can make lower monthly payments to the scammer's company, and the payments will be credited the principal of the original mortgage. While the homeowner is making these payments, the scammer is keeping the money, and often using a home equity line of credit to suck out any remaining home equity. Soon the homeowner learns he or she is in further debt, and has added the burden of new liens from the scammer's home equity loans on the house. In almost every case where there is no legal intervention, the homeowner loses the home to foreclosure, all the money paid to the scammer as rent, and home equity that has built up over the years.

Based on our experience, Realtors would like to share six recommendations on how to prevent foreclosure scams. First, we recommend that Congress enact legislation that puts disclosure requirements and minimum levels of service on people who offer to rescue homeowners from foreclosure. My home State of Minnesota passed such a law in 2004, which has proven successful and resulted in 12 lawsuits against predatory programs in just the last year.

H.R. 1231 creates a fair balance between legitimate housing counselors and consultants that provide beneficial services to struggling homeowners and those predatory practices that take advantage of families who are facing foreclosure. As introduced, this bill provides an exemption for licensed real estate professionals similar to the 2004 Minnesota bill. Exempting these professionals when

they are engaged in their normal business practices will allow Realtors to continue to offer these valuable services to their clients. Consumers rely on Realtors for their professional service, and trust their code of ethics. We urge passage of this important legislation.

Second, lenders and servicers should be more aggressive in helping distressed homeowners. Too often we hear from Realtors that borrowers seeking help from a lender are told that nothing can be done until they are at least 90 days delinquent. We believe this increases the chance that a homeowner may turn to a mortgage rescue scam in order to get help.

Third, Realtors believe legitimate foreclosure prevention options need to be widely advertised, especially in areas where rescue scammers like to operate.

Fourth, the process for closing a short sale needs to be considerably shortened. NAR hears every day from members frustrated that servicers take months to even consider a short sale. Potential buyers, in the mean time, get frustrated and give up, while homeowners become even greater prey for scammers.

Fifth, the private sector should be actively educating home buyers about safer affordable mortgage products.

And, finally, NAR believes that the government needs to increase funding for financial counseling and consumer education programs to help borrowers avoid foreclosure.

In conclusion, Realtors across the Nation believe anti-predatory lending reforms are required to restore consumer confidence in the housing industry, and avoid another housing crisis in the future.

Historically low mortgage interest rates and significant tax credits for first-time home buyers have enticed consumers back into the housing market. However, we believe that wholesale reform of the mortgage lending sector will give consumers the protections they need and will remove the last impediment to a housing recovery.

NAR supports lending reforms that protect the consumer, but ensures them reasonable access to mortgage capital, so that the American dream of sustainable homeownership can still be available.

Thank you very much for your time, and I look forward to any questions.

[The prepared statement of Mr. Anderson can be found on page 38 of the appendix.]

Chairwoman WATERS. Thank you all very much for your testimony. I recognize myself for 5 minutes. Let me first say to Mr. Scott Drexel, chief trial counsel of the State Bar of California, I really appreciate your no-nonsense attitude. We do have a copy of the ethics alert that you did, which I think was very, very good, and it certainly should have put everybody on notice. But I guess there are some people who just don't believe, as the old folks would say, fat meat is greasy.

So, we're going to have to do what is necessary to avoid the opportunity for these scam artists to continue to harm our would-be homeowners that find themselves in foreclosure problems. And so, I am opposed to exemption for anybody. I think that it is very, very hard to nuance it so that you can track it.

Now, I do have some sympathy for—or some questions about—the filing of bankruptcy. That is legitimate work for lawyers. And

in the filing of bankruptcy, if it is considered that, in that work, it is loan modification, and it would prevent the lawyer from proceeding with legitimate bankruptcy work, then I think that needs to be looked at.

So, Mr. Drexel, could you help me to understand whether or not we have a problem exempting lawyers if, in fact, they are involved with—we have a problem trying to protect lawyers so that they can do this work, if, in fact, they do do this work by way of bankruptcy?

Mr. DREXEL. Well, Madam Chairwoman, I would not have a problem with that. The fees charged by attorneys in bankruptcy proceedings are reviewed and approved by a bankruptcy judge or trustee. And so, that provides some measure of protection to the consumer. My concern is that with receiving fees in advance, even in the loan modification area, attorneys are free to provide services for clients. The preclusion would simply be upon getting money up front.

And so, we would look to find ways to encourage attorneys—and many attorneys do, on a pro bono basis, assist people in this area. But even on a compensated basis, we're not seeking to preclude them performing the services, but simply from receiving money up front for that, but rather charging it as they perform the services.

Chairwoman WATERS. And isn't it true that in the final analysis, when you have foreclosure that would end up in a bankruptcy, that—if our bankruptcy legislation is signed by the President—in the final analysis, isn't it the judge who is determining whether or not there is going to be a write-down of principal, or a deduction of interest? And they, indeed, are the ones who are doing the modification?

Mr. DREXEL. That is my understanding.

Chairwoman WATERS. All right. So, having said that, you're sitting next to the Realtors, who think that they have some special knowledge and concern, certainly, in this area. Should they be exempted?

Mr. ANDERSON. Well, thank you for the question. You know, on a daily basis—

Chairwoman WATERS. I was asking Mr. Drexel.

Mr. ANDERSON. Oh, I'm sorry.

Mr. DREXEL. I'm sorry.

Chairwoman WATERS. I know what—

Mr. DREXEL. No, Madam Chairwoman, I do not. And in California, real estate brokers and sales people are not exempted, they are not permitted to receive money in advance of performing the services. And it has been that way for the last 30 years now.

Chairwoman WATERS. And so, Mr. Anderson, what do you think about that?

Mr. ANDERSON. Well, I would agree. I believe right now Realtors don't get any fees up front. I would be very cautious of any type of exemption that would be broad-based, and the reason being is I know right now, on a daily basis, I am meeting with people because they trust me and they come to me and ask me for advice. So anything that would tie my hands I would be very concerned about.

So, I guess we would have to go and discuss that, you know, if the exemption came through. But we would agree with the up-front fees, because right now we don't collect up-front fees.

Chairwoman WATERS. Let me just also say, before my time is up, that this problem really lies with the servicers. The servicers, whether they are independent, or whether it's a servicing company, such as the one that's owned by Wells Fargo—they have their own servicing company—it seems to me our responsibility is to make sure that they have adequate numbers who are servicing, that they have ways by which people can reach them more easily than they are able to do now, having enough telephone lines, having competent, trained servicers.

They are the ones who are holding this paper. They're the ones that are initiating these foreclosures, these loan initiators. And we just have to make them do what they are supposed to be doing.

All right. Thank you. And with that, I will turn to, I suppose, Mr. Cleaver for 5 minutes.

Mr. CLEAVER. I just wanted to express my appreciation to my colleague, our colleague, Ms. Moore, for introducing this legislation. And when you consider that mortgage fraud is up 26 percent from last year, it shows that people will take advantage of anything. And I appreciate those of you who came today to provide us with information. I yield back the balance of my time.

Chairwoman WATERS. Thank you. Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. I would like to associate myself with the remarks of Mr. Cleaver and the chairlady. I think that we do have a problem, in terms of servicers having a limited amount of capacity. And I think that capacity is what allows these fly-by-night businesses to do what they do.

I would like, if I may, to ask someone, any one of you, how can we, in your opinion, enhance the capacity—as the chairlady has said, it is a problem—how do you perceive us enhancing that capacity? And I would like for Ms. Saunders, if you would, to give your opinion.

Ms. SAUNDERS. Enhance the capacity among the servicers?

Mr. GREEN. Yes, ma'am.

Ms. SAUNDERS. By telling them to do it. I mean, for years we have been trying to rely on voluntary efforts, and they are not working. And we have new program after new program, and we say, "Aha, this one is going to give them the incentive to participate. Well, maybe this one will give them the incentive."

And it's time to give up on voluntary efforts and say, "You have to give somebody a contact person who you can reach, who has the authority and information you need, and you have to go through this process to consider a reasonable loan modification, before you can embark on foreclosure."

Mr. GREEN. Mr. Story?

Mr. STORY. Well, I think we all agree that it's unfortunate that there is a capacity issue, or there has been a capacity issue with servicers. But there is a financial incentive for servicers to make sure that they can modify loans that are able to be modified.

So, the servicers are actively trying to do this as quickly as possible. They're hiring more people, they're putting in sophisticated technology in their telephone systems in order to get to the cus-

tomers as soon as possible when they call. So there is a big effort out there. It could always be better, but there is a true incentive for them to get this done as quickly as possible.

Mr. GREEN. Mr. Anderson?

Mr. ANDERSON. You know, it's interesting that we have given them the money in order to shore them up, but I can tell you from someone who meets with these consumers every single day, the reason why they are struggling so badly is that they call their lenders, they call the loan servicers, and they don't get any help. And then I will get on the phone with them, I will try to assist them.

And someone asked the question previously about why loan modifications go back into foreclosure again. The reason being is that they don't modify it enough. And if they really truly want to keep them in the homes, then they need to say, "We are willing to take something and cut it right now in order to keep these people in homes," because it's not just good for them, it's good for their neighborhoods.

I work in Mr. Ellison's neighborhood, I work in—all around there. And we need to help these people get—be able to get in contact and get a reasonable amount of time to get answers back on modifications, short sales, and advice.

Mr. GREEN. Mr. Drexel?

Mr. DREXEL. Representative Green, with all due respect, I don't feel qualified to intelligently respond to your question, since my area is more the regulation of attorneys.

Mr. GREEN. Let me just have one follow-up. Do you think that the $1,000 incentive, the incentives that we have given to maintain a loan, that those things are helping to some extent? Ms. Saunders?

Ms. SAUNDERS. The numbers are getting better, but they are just not there yet. And, sure, every little incentive helps a little bit, but I think it is time to stop with the carrots, and we need some sticks, too. The numbers still are that, even for the people who get loan modifications, only about half of them are getting a reduction in payment. About half of the loan modifications are ending up in foreclosure.

And so, we need to say, "This is what you have to do. You have to consider it, and it has to meet these standards." And, by the way, the standards need to be transparent. That is one of the things that we are asking for in the Administration plan is that everybody ought to know what is the formula, what do you have to do to qualify, so we can hold them to it.

Mr. GREEN. Mr. Story, is it helping at all?

Mr. STORY. I think that the $1,000 is not necessarily an incentive, but it is helpful in covering the costs. And there are areas where—I mentioned HOPE NOW in my talks, and we have seen over 3 million modifications with that organization. So there is some modification—

Mr. GREEN. Just one follow-up with you, Mr. Story. I—you are among the first to tell me this, that you had—did you say 3 million?

Mr. STORY. Right.

Mr. GREEN. Do you have any empirical evidence to support the premise?

Mr. STORY. I don't have it with me today, but I can get you that information.

Mr. GREEN. Okay. And, if you would, in so doing, give me the definition of modification you are utilizing.

Mr. STORY. Sure, no problem.

Mr. GREEN. Thank you. I thank you, Madam Chairwoman, I am going to yield back.

Chairwoman WATERS. Thank you very much. Next, we have Mr. Ellison.

Mr. ELLISON. Thank you, Madam Chairwoman. Thank you, Madam Chairwoman, very much.

Mr. Anderson, I would like to ask you a question about, you know, a Minnesota approach. Thanks for discussing the foreclosure reconveyance statute in our home State. Can you talk to us today about how that statute defines a foreclosure consultant? And how does that differ from the scope of H.R. 1231?

Mr. ANDERSON. Thank you. Actually, it is very close in relationship, the bill—the two bills. And it is—it does exempt Realtors and those who are legitimate types of organizations that are trying to give advice. It prohibits up-front fees. It prohibits an automatic conveyance to the person that is, you know, the provider, and so forth.

So, the Minnesota bill did a terrific job, and went a long way. And I think this bill, likewise, does a terrific job and matches up very closely in lots of ways.

Mr. ELLISON. Do you feel it has had a chance to demonstrate some results? I mean, do you think it is working?

Mr. ANDERSON. I think it is working, and the statistics prove that it is working. I think what the Federal bill would do will help in a broader scope, because I know that one of the large companies that our attorney general went after just recently was out of Florida. And so it does cross State lines. And so I think the Federal bill, then, I think will assist State attorneys general in doing this.

Mr. ELLISON. Thank you. Ms. Saunders, do you think that the foreclosure prevention fraud legislation should only cover foreclosure consultants and loan modification specialists? Should we cast the net a little wider?

Ms. SAUNDERS. Are you talking about the sale lease-back transactions? Or what are you getting at in terms of—

Mr. ELLISON. I am talking about the scope of H.R. 1231.

Ms. SAUNDERS. Okay.

Mr. ELLISON. Yes.

Ms. SAUNDERS. I think the scope is appropriate. And, frankly, my concern, from the attorney perspective, is how broad it is. We all have in our mind what these loan mod firms look like. But the language, of course, is written more broadly to govern a variety of services that are represented will help with foreclosure.

And so, I think you need that flexible language in order to address the variations that these schemes can take. I mean, this bill is patterned after State legislation that was written long before anybody had heard of a loan modification. And yet, it is useful.

But, to the extent you do have a broad definition, you have to be careful about what you are catching within that. A lawyer who looks at a predatory loan and charges a fee to review the docu-

ments and identify claims and write a demand letter, well, they are doing that to try to stop a foreclosure. But we don't want to stop that.

Mr. ELLISON. Right.

Ms. SAUNDERS. So, yes, I think the scope is appropriate, but we need to be careful about how it relates to legitimate attorney services.

Mr. ELLISON. Do you think that the penalties in H.R. 1231 are sufficient?

Ms. SAUNDERS. I would recommend strengthening them. I think simply returning the fee isn't much of a penalty. You get a lot of fees from 1,000 people, and if a couple of them speak up and squawk, well, that is the cost of doing business.

So, you know, I would say that double or treble damages would be more appropriate.

Mr. ELLISON. You know, I just want to observe that if you are talking about a Realtor, a licensed Realtor, or an attorney, if they do something that is unethical, they are going to have to deal with much more than returning a fee. But for people who are—don't fit in either category who do operate in this area, all they are doing is returning the fee. So the incentive to stop is not as strong.

What would you recommend, in addition to what is in the bill?

Ms. SAUNDERS. You could add in statutory penalties, or triple the amount of the fee, the damages or triple the amount of the fee.

But damages, you are going to get into a fight about whether the person was going to lose their home anyway. So you are not always going to get those damages. So, I would say triple the amount of the fee.

Mr. ELLISON. I see. Now again, Ms. Saunders, I want to ask you, in your opinion, would a reporting requirement be useful? And, if so, should—would a reporting requirement be useful? And then, if you think so, then I have some follow-up for you.

Ms. SAUNDERS. Okay. If you—in terms of the loan mod firms reporting their data, what they are doing?

Mr. ELLISON. Yes.

Ms. SAUNDERS. I think that is something that States might want to consider. I am not sure that it really works so much at the Federal level.

I do have concerns about some of the State laws that have gone down the licensing route, because we don't want to legitimize these firms. On the other hand, if you tie that to a heavy bond requirement and a requirement to actually report data to the State agencies that can look at it, definitely at the State level, I think that can be useful. I'm not sure it makes sense in the Federal bill.

Mr. ELLISON. Okay. You noted in your testimony that California passed mortgage foreclosure fraud legislation back in 1979. Yet we still have the problem. What do you think caused the law to—why do you think we still have it? Was the State law not strong enough? Do you think it was ineffective? Do you think it helped some, but not enough? How do you see the situation?

Ms. SAUNDERS. It does help some. And I am actually a California lawyer. I spent 15 years with a legal services office in Los Angeles. And we used California's law, among others, to go after the equity-stripping scams that were prevalent back then.

It does have a number of exemptions. And, we have talked about the problems that those create.

I also think it does allow certain fees that are not always appropriate. Like I said, we recommended that the fees be tied to results, both in State legislation as well as Federal.

Mr. ELLISON. My time is up, so let me thank all the panelists, and thank the Chair.

Chairwoman WATERS. Thank you very much. Ms. Moore?

Ms. MOORE OF WISCONSIN. Oh, thank you so much, Madam Chairwoman, and I want to start out by thanking my colleagues for remaining through this second panel, and really, really delivering these—offering these very sage questions that really are, I think, going to improve this legislation.

And so, with that, I am going to try to follow up on some of the things that my colleagues have asked. And before I do that, I want to single out Ms. Saunders for working with me and with Chairwoman Waters on this legislation to try to perfect it. And I also want to thank Mr. Drexel and Mr. Anderson, in particular, for traveling and coming here with their great examples of what is happening in their States.

The chairwoman started out, Mr. Drexel, by asking you about the attorneys' fees. And I thought there was some really important information that was conveyed there. She talked about, in the case of a bankruptcy, that the fees are typically approved by judges. And loan modifications are approved by judges.

So, are you saying—and I don't know the answer to this question, I'm not a lawyer—but that lawyers will enter into this bankruptcy work, knowing that, as the process moves forward, that the judge—it can start out pro bono, and that the judge will approve monies that maybe they take from their own accounts and pay—and reimburse them for work that they have done? Is that what I need to understand?

Mr. DREXEL. Well, my understanding is, Representative Moore, that in bankruptcy proceedings, that the court does have to approve all the fees that are paid, that monies that are paid in advance go against the amount that the court approves. But, in most cases, I don't believe that attorneys in bankruptcy proceedings are allowed to get advance retainers.

So, I think the protection provided by the bankruptcy judge or trustee, in reviewing the fees that are received, provides a protection to the consumer that those—that the bankruptcy is legitimate, and the fees that are charged by the attorney are for services that are actually performed.

Ms. MOORE OF WISCONSIN. So I mean, do people—do attorneys get retainers from people or not in bankruptcies before they are approved?

Mr. DREXEL. In my experience, they—

Ms. MOORE OF WISCONSIN. What we are trying to prevent here—and I think Ms. Saunders mentioned it as well, I mean—we were trying, when I was working with Ms. Waters, we were trying to come up with a middle ground where we don't stop legitimate activities. I mean, some of these people's homes may be able to be saved, and we are not trying to prevent legitimate activities of at-

torneys for being contracted for—you say your folks are not getting any money, and you even said you are not against that.

Mr. DREXEL. Right.

Ms. MOORE OF WISCONSIN. So, we are trying to craft something that is going to make sense. So—

Mr. DREXEL. To my knowledge, they do not.

Ms. MOORE OF WISCONSIN. Okay. So, you're saying—so if my legislation exempts attorneys, it wouldn't have any impact on whether or not an attorney would get involved in stopping a bankruptcy?

Mr. DREXEL. It does not preclude them from doing that, that's correct.

Ms. MOORE OF WISCONSIN. Okay. Okay. Same thing—what about stopping a foreclosure?

Mr. DREXEL. Well, the same thing. Whether they can get a retainer or not in advance does not preclude them from performing services and for reaching an agreement with the consumer as to what the fair compensation for the services they provide.

Ms. MOORE OF WISCONSIN. Okay, so—

Mr. DREXEL. The problem with getting the money up front, of course—

Ms. MOORE OF WISCONSIN. Okay. So, Ms. Saunders—because my time may expire—I want you to get involved in this a little bit.

What I am trying to prevent, you know, I don't want to put something in law, or in statute here, that would be so heavy-handed that it would prevent these other activities that aren't related to rescue scams.

In your opinion, if I did not exempt attorneys at all, did not put any language in, would that have a chilling impact on legitimate work that attorneys were doing?

Ms. SAUNDERS. If there were no exemption for attorneys, and no qualifications on that lack of exemption, yes, I think that would be a big problem.

Without trying to write the language here—obviously we are all trying to get to the same result, to try to figure out how to define that middle line. Maybe there is something in terms of how you define an advance fee with an exemption for a retainer, an attorney who is acting in compliance with all ethical rules of their State.

As you long as you carve out the non-attorneys who are using the cloak of the attorney license, there may be ways in which you can narrow that attorney exemption so that it doesn't expand.

Ms. MOORE OF WISCONSIN. Thank you—

Chairwoman WATERS. Will the gentlewoman yield for—

Ms. MOORE OF WISCONSIN. Absolutely.

Chairwoman WATERS. Yes. As I understand it, your amendment does exempt attorneys who are filing bankruptcies. And we further modified that to make sure that they were not frivolous lawsuits, or something like that.

So, are you asking about something beyond that?

Ms. MOORE OF WISCONSIN. Well, I—you know, I want to make sure that—okay, you accepted that amendment from me, but I was wondering whether we should go further. And, if we were to go further, would that have a chilling impact?

So, I am just trying to make sure we have the right balance.

Ms. SAUNDERS. Can I respond?

Ms. MOORE OF WISCONSIN. It is up to the Chair, because my time has expired.

Chairwoman WATERS. Go right ahead.

Ms. MOORE OF WISCONSIN. Okay.

Ms. SAUNDERS. Okay. The concern about the language in the amendment as offered last week is that it ties the exemption to litigation, to being in court. And attorneys do things short of going to court. Like I said, we review loan documents for a fee. We don't promise to go to court. Others write demand letters. Any good lawyer is going to try to resolve it out of court before going to court.

So, if you make the line be you're okay if you go to court, but you're not if you don't, that can be a problem.

Chairwoman WATERS. Okay—

Mr. DREXEL. Representative Moore, I wonder if I could—

Chairwoman WATERS. If the gentlewoman would yield further—

Ms. MOORE OF WISCONSIN. It is up to the Chair at this point.

Chairwoman WATERS. Yes. Who is it who wants to speak? Yes, sir.

Mr. DREXEL. I am sorry, I just wanted to make a comment. I think the distinction here is between—I know part of the issue was whether the receipt of fees should—or compensation should be dependant upon results, you know, versus getting money up front.

And I think, with attorneys, for instance, that the issue should be whether they are being paid for services they have already provided, not necessarily results, because sometimes the—they can't get the results, but they have definitely performed services—versus getting money up front.

In California, attorneys who get advance fees are not required to place those fees in a trust account until they are earned. And so, getting the money up front basically encourages the fraud, encourages these loan modification consultants and the like to try to hook up with attorneys, to get them to get large parts of—large amounts of funds up front, which they then share with them.

By allowing attorneys only to bill for services that they have actually performed themselves after the fact, I think that eliminates that problem, and does not require them to perhaps not get paid if they are not successful in getting the loan modification.

Ms. MOORE OF WISCONSIN. So, in other words, if they found some papers and it cost them $200 for a filing fee, they would have to pay that out of their own attorney accounts and then get reimbursement for it.

Mr. DREXEL. Correct.

Ms. MOORE OF WISCONSIN. But that would solve it. Okay. I just have a comment. Would—

Chairwoman WATERS. Please, go right ahead.

Ms. MOORE OF WISCONSIN. One of my other colleagues who is no longer here—a couple of them have made some really good points, Madam Chairwoman, that—we were talking about the limited capacity of servicers, and there was a—you know, I think that 84.3 percent of the folk who got us into this mess with poor underwriting were non-banking entities.

And so, those people have sort of disappeared from the marketplace, you know, now. So now we are asking servicers and banks to modify them, and they, in fact, may not have the employees, and

may have to hire them. Maybe we need to figure out how to do that. But I do believe we need to give up on volunteerism.

And Mr. Ellison made a point, that the penalties need to be strengthened, and I just wanted to clarify that you thought treble damages was the right balance?

Ms. SAUNDERS. Yes.

Ms. MOORE OF WISCONSIN. Okay.

Ms. SAUNDERS. That is what is in some other statutes.

Chairwoman WATERS. Thank you very much, Ms. Moore. We have legislation that we are proposing to put something in law to oversee and regulate servicers. This is an unregulated industry. And we are taking a very, very close look at how to do that.

Some of the people here today have testified that we need to give more support to the housing counselors who are trying to help homeowners. However, we have found—I convened housing counselors. They, too, cannot get in touch with the servicers. They have the same problems—calling the telephone numbers, not getting answers, or getting a menu that does not work.

And so, it is not so much we need more counselors, as we need the banks to hire—and the servicing companies to hire—more people, make them more accessible, and be willing to really do loan modifications with trained people. And we are really taking a look at how to do that.

Thank you, ladies and gentleman, for your participation. Ms. Capito, I understand you don't have any questions. Do you have a statement?

Mrs. CAPITO. No, I don't. I have no questions. I just wanted to thank the panel. I'm sorry I was in and out so much, but I appreciate your input. Thank you.

Chairwoman WATERS. Thank you very much. And, of course, we may have additional questions, and the record will remain open for 30 days for those members who would like to raise additional questions about this hearing.

With that, this hearing is adjourned. We are going to go to the Floor, where another important bill is on the Floor, and see if we cannot participate in that. Thank you very much.

[Whereupon, at 11:57 a.m., the hearing was adjourned.]

A P P E N D I X

May 6, 2009

NATIONAL ASSOCIATION OF REALTORS®

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HEARING BEFORE THE

UNITED STATE HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

ENTITLED

"LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD"

WRITTEN TESTIMONY OF

JOHN W. ANDERSON, ABR, CRB, CRS, GRI

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

MAY 6, 2009

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

EQUAL HOUSING OPPORTUNITY

Introduction

Chairwoman Waters, Ranking Member Capito, and Members of the Subcommittee, thank you for the opportunity to testify before you. My name is John Anderson and I am a broker/owner of Twin Oaks Realty in Crystal, MN. I am the 2009 Vice Chair of the National Association of REALTORS® (NAR) Federal Housing Policy Committee, and a member of NAR's 2009 Public Advocacy Advisory Group.

I am here to testify on behalf of 1.2 million members of the National Association of REALTORS®. We thank you for the opportunity to present our views on the problems with foreclosure rescue scams and need for mortgage reform. NAR represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

REALTORS® Want to Protect our Nation's Homeowners

Irresponsible and abusive lending practices are a major problem for our nation's communities. While responsible subprime lenders have played an important role in helping millions of consumers achieve homeownership, abusive lending occurs much too often in subprime markets. Unfortunately, some lenders have abused their role and taken advantage of vulnerable borrowers, by charging extremely high interest rates and loan fees unrelated to risk, using aggressive sales tactics to steer consumers into unnecessarily expensive or inappropriate loan products, advertising "teaser" interest rates (like the 2/28 or 3/27 adjustable rate mortgage) that steeply increase after the first few years of the loan and basing their lending on artificially high appraisals. Real estate professionals have a strong stake in preventing abusive lending because:

- Abusive lending erodes confidence in the Nation's housing system.
- Legislative and regulatory responses to lending abuses that go too far can inadvertently limit the availability of reasonable credit for prime as well as subprime borrowers in a

credit-driven economy. When responses to abusive lending constrain the ability of the secondary mortgage market to provide liquidity for home finance, consumers will find it more difficult and expensive to buy a home.

• Citizens of communities, including real estate professionals, are harmed whenever abusive lending strips equity from homeowners. This is especially the case when irresponsible lenders concentrate their activities in certain neighborhoods and create a downward cycle of economic deterioration.

Foreclosures Devastate the Strength and Stability of Communities

The consequence of lending abuses is higher rates of foreclosures leading to the loss of families' homes and savings and increased vacancy rates which, in turn, can cause all homes in a neighborhood to lose value. In my own state of Minnesota, foreclosures continue to rise, although at a slower pace than in previous years. Foreclosure filings in 2007 almost doubled from 2006. In 2009, the rate increased by 29% to 26,268[1].

I can tell you first hand that the impact of foreclosures is unmistakable. According to research conducted by the Woodstock Institute, a foreclosed home lowers the price of surrounding homes by about 1 percent.[2] The same research also found that each additional foreclosed home within an eighth of mile lowered the values by an additional percent. The Center for Responsible Lending (CRL) projects that more than 2 million American households with subprime loans will have lost their homes by the end of 2009, up from the original estimate of 1.1 million made in 2006. Additionally CRL estimates that 40.6 million homes in neighborhoods surrounding those foreclosures will suffer price declines averaging over $8,667 per home and resulting in a $352 billion total decline in property values.[3]

Someone once said that foreclosures are like mold — once it starts, it's difficult to rid a community of it. Families struggling to make mortgage payments and who live in a

[1] Foreclosures in Minnesota: A Report Based on County Sheriff's Sale Data, Housing Link, February 26, 2009.

[2] There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values, Woodstock Institute (June 2005).

[3] Updated Projections of Subprime Foreclosures in the United States and Their Impact on Home Values and Communities, Center for Responsible Lending (August 2008)

neighborhood where homes have already been lost to foreclosure will find it difficult to refinance or sell due to declines in area home values. Far too often the financially stressed family will end up losing their home and feeding the vicious proliferation of foreclosures.

Foreclosure "Rescue" Scams

The most pervasive foreclosure "rescue" scam is the "reconveyance" which may or may not involve equity stripping. Generally, the scam goes like this:

- A homeowner falls a few months behind on their mortgage payment and has just received a notice of pending foreclosure from the lender.
- The homeowner responds to an advertisement or a letter that typically says, "Want to avoid foreclosure and stay in your home? Call now. Time is of the essence. The foreclosure timeline has already started."
- The foreclosure "rescuer" or "counselor" makes promises of a fresh start and rebuilding credit by bringing the mortgage current. In exchange for paying the mortgage arrears, the homeowner is asked to sign a quitclaim deed and told he or she can remain in the house as a renter.
- The "rescuer" or "counselor" explains that every month, the homeowner makes a payment (i.e. rent) to his company, which will be lower than their current mortgage payment. The homeowner is also told that every payment will be credited to the principal of the original mortgage and will help them to repurchase the home in a few years.
- While the homeowner is making monthly payments to the "rescuer" or "counselor," the scammer is not making payments on the original mortgage. Instead the "rescuer" is keeping those payments (really, stealing) from the family and often using a home equity line of credit to suck out any remaining equity in the home.
- Soon, the homeowner learns they are further in arrears with the original lender and have the added financial burden of new liens for the scammer's new home equity loans. In almost every case where there is no legal intervention, the homeowner loses the home to foreclosure, loses all the money paid to the scammer as rent, and loses all the home equity that has built up over the years.

Transfer of ownership generally does not relieve the homeowner of their mortgage debt obligation. Most conventional mortgages have a "due on sale" clause that prevents a transferee (in foreclosure "rescuer" scams, the transferee is the scammer) from assuming the mortgage obligation. Typically, the only way to be released from liability of mortgage debt is to pay off the property's mortgage, either from proceeds of a sale or at the end of the term of the mortgage.

In addition, new scams related to mortgage modification are becoming a growing problem. These unscrupulous businesses claim to be affiliated with the government and ask homeowners to pay high up-front fees to qualify for government mortgage modification programs. Often these companies have names similar to government programs – including use of the Troubled Asset Relief Program (TARP) acronym or other federal programs.

We are pleased that the Administration is taking a firm stance on foreclosure rescue and loan modification scams. President Obama has convened a new coordinated effort across federal, state, and local governments, and the private sector to target mortgage loan modification fraud and foreclosure rescue scams that threaten to hurt American homeowners and prevent them from getting the help they need during these challenging times. Multiple agencies are involved and are helping protect consumers from these types of fraud. Currently the FBI is investigating more than 2,100 mortgage fraud cases, up almost 400 percent from five years ago.

In the last year, the Federal Trade Commission (FTC) has brought 11 cases against companies using deceptive tactics to market their mortgage modification and home foreclosure relief services. On the state level, more than 150 enforcement actions have been brought against mortgage rescue companies.

Minnesota's "Foreclosure Reconveyance" Statute

In 2004, Minnesota took a significant step to protect its citizens from becoming victims of foreclosure "rescue" scams by enacting a law that sets forth a series of complex requirements applicable to persons who offer to help stop or postpone a foreclosure ("foreclosure

consultant").[4] The mortgage foreclosure law requires that if a transaction falls within the statutory definition of "foreclosure reconveyance,"[5] all details of the transaction must be in a written contract, including the exact nature of the foreclosure consultant's services and the total amount and terms of compensation. The Minnesota statute requires that a notice be included in the contract and be printed in at least 14-point boldface type alerting consumers that foreclosure consultants cannot take money or ask for money prior to completing their work and they cannot ask the homeowner to sign any lien, mortgage or deed.[6] Probably the most important provision of the state mortgage foreclosure law is the additional right of the homeowner who engages the services of a "foreclosure consultant" to cancel the contract for services within three business days. The statue requires that a separate "Notice of Cancellation" be attached to each contract.[7] The Minnesota statute also includes strong remedies for violations by foreclosure consultants including a private right of action and criminal penalties (including imprisonment). In the last year alone, Minnesota Attorney General Lori Swanson has brought 12 lawsuits against fraudulent foreclosure consultants operating in the state.

One important provision in the Minnesota legislation is that it exempts from the definition of "foreclosure consultant" real estate professionals who are acting in their capacity as trusted advisors to their clients. Especially in our current housing environment, REALTORS® often assist their clients with information on foreclosure processes, short sales, and loan modifications. Consumers rely on REALTORS®for their professional expertise, and trust their Code of Ethics. Exempting these professionals when they are engaged in their normal business practices, will allow REALTORS® to continue to offer these valuable services to their clients. Similar exemptions are provided in other federal laws, such as the SAFE Act and the mortgage reform bill being debated in the House, HR 1728, the "Mortgage Reform and Anti-Predatory Lending

[4] Minn. Stat. §325N (2004). See Minn. Stat. §325N.01(a) and (b) for complete definition of "foreclosure consultant." Generally, NAR does not take positions on state statutes and does not have a position on Minn. Statute325N. The Minnesota Association of REALTORS® supported the final version of MN Statute 325N when it was enacted in 2004.

[5] Minn. Stat. §325N.01(c) (2004).

[6] Minn. Stat. §325N.03(b) (2004).

[7] 18 Minn. Stat. §325N.03(e) (2004).

Act". We are pleased to see that H.R. 1231, the "Foreclosure Rescue Fraud Act of 2009", sponsored by Rep. Moore (D-WI) includes similar language.

H.R. 1231, the "Foreclosure Rescue Fraud Act of 2009"

NAR is happy to endorse, H.R. 1231, the "Foreclosure Rescue Fraud Act of 2009". This bill provides a federal definition of a "foreclosure consultant" and would prohibit these individuals or companies from receiving any compensation from a homeowner prior to completing services; holding power of attorney or interest in a home for a homeowner; or accepting a lien or other security on a home as payment for services.

The bill creates a fair balance between legitimate housing counselors and consultants that provide beneficial services to struggling homeowners and those predatory practices that take advantage of families who are facing foreclosure. The bill provides some federal minimum standards for legitimate businesses, while not preempting stronger state laws.

We support this legislation that will ensure that homeowners in need do not fall prey to unscrupulous foreclosure rescue consultants.

Homeowners Have Legitimate Options to Prevent Foreclosures

There are a number of other steps that we believe are in order to prevent the proliferation of more foreclosure scams. In order for a foreclosure "rescue" scam to be successful, the "counselor" must cut off the homeowner's access to all legitimate foreclosure prevention options. They do this by preying on the vulnerability of homeowner, often instructing them to not contact the lender or an attorney because it will preempt the "rescuers" negotiations to stay the foreclosure. For many Americans who are embarrassed and do not want to be a burden on family or friends, the foreclosure "rescue" seems like a great option and the "counselor" seems like they really want to help. But as detailed above, it is the worst option and, by some measures, even more terrible than a foreclosure where any remaining equity in the home is returned to the borrower when the mortgage debt is paid.

We think that lenders and servicers should be more aggressive in helping distressed homeowners. Too often, we hear reports from our members that borrowers seeking help from their servicer or lender are told nothing can be done until they are at least 90 days delinquent. Too often, even when the loan is modified, the late payments are simply added to the end of the loan or the loan is modified in a way that actually increases the monthly payments. Borrowers often end up in an even more precarious financial situation and are even less likely to get back on their financial feet. As a last desperate gamble, they may turn to a mortgage "rescue" scammer. The Obama Administration's Making Home Affordable Loan Modification Program seeks to address these problems by providing incentives to investors and servicers that modify the loans of at risk borrowers who are not yet delinquent and by assuring a significant decrease in monthly payments, and we hope that loan modifications under the new program will succeed.

Similarly, some homeowners want or need to sell their home but owe more than their home is worth. This means they must obtain lender approval of a short sale. In a short sale, the lender or lenders agree to accept less than the outstanding principal on the loan and nevertheless release the lien. Lenders have a financial interest to do so because the alternative—foreclosure—almost always costs the lender more than accepting a reasonable short sale offer. But the reality is that getting a short sale approved is extremely difficult and time-consuming. NAR hears every day from members frustrated that servicers take many months to even consider a short sale and are unrealistic about the current value of the home. Potential buyers get frustrated and give up. Because the process for getting a short sale to closing is, we think, broken, homeowners become easier prey for scammers in this situation as well. NAR has been working with lenders, their representatives, Fannie Mae and Freddie Mac, and government agencies on ways to improve the short sale process. Unfortunately, little progress has been made.

It is critical that foreclosure prevention options be widely advertised and available, especially in areas where we know rescue scammers like to operate. The general nature of a homeowner who is behind on their mortgage payment is to avoid contact with the lender. We are hopeful that these attitudes and behaviors will change now that there is widespread messaging from our federal government that help is a phone call away at 1 888 -995-HOPE for free foreclosure counseling assistance.

NAR supports the efforts of the Making Home Affordable initiative, which is a broad-based collaboration between credit and homeownership counselors, lenders, investors, mortgage market participants, and trade associations and endorsed by the Department of the Treasury and the Department of Housing and Urban Development (HUD). Since May 2007, NAR has actively promoted the 1-888-995-HOPE hotline number in numerous publications and on the highly visited REALTOR.org website.

NAR strongly believes the private sector has an obligation to help educate homebuyers about today's mortgage products. Starting in 2005, NAR worked with the Center for Responsible Lending (CRL) to produce a series of brochures that describe the pros and cons of conventional loans and nontraditional mortgages, and give consumers tips on how to avoid predatory loans. In May of 2007, NAR partnered with CRL and NeighborWorks, on a brochure that focuses on helping financially stressed homeowners understand their options and offers tips on how to avoid foreclosure. Shortly after the brochure was released, NAR's President sent an e-mail to over 1.3 million REALTORS® informing them of the foreclosure prevention brochure and encouraging REALTORS® to put the brochure into the hands of every consumer they help to become a homeowner. These consumer education brochures are readily available on NAR's website. Anyone may download them for free, and we also provide thousands to our consumer partners for distribution. And the glossy version is also available for purchase at a reasonable cost.

NAR also supports increased funding for programs that provide financial assistance, counseling, and consumer education to borrowers to help them avoid foreclosure or minimize its impact. In fact, NAR in March of this year launched a $3 million Foreclosure Prevention and Response initiative to provide funding to all state and local Realtor® associations to assist them in devising and implementing plans to respond to the current foreclosure crisis. These plans will be fully in accord with locally identified needs and are aimed primarily at educating and training Realtors® to help consumers through counseling and the proper handling of troublesome transactions such as short sales. This funding will also help Realtors® team up with local governments and other community organizations to address the adverse impacts of foreclosures.

Need for Mortgage Reform

Finally, REALTORS® across the nation believe anti-predatory lending reforms are required to restore consumer confidence in the mortgage industry. Historically low mortgage interest rates and a significant tax credit for first-time homebuyers have begun to entice consumers to get back into the housing market; however, wholesale reform of the mortgage lending sector to give consumers the protections they need, will, we believe, remove the last impediment preventing a housing recovery.

Congress' efforts to reform mortgage lending are paramount not only to the housing recovery, but to the recovery of the national economy. As I, and many of my REALTOR® colleagues, have mentioned in prior testimony to this and other Congressional committees, housing has always led our economy out of downturns, and it will again -- once the appropriate measures are put in place to prevent recurrence of the past irresponsible and abusive lending practices, which are largely responsible for causing the problems we are experiencing today.

As Congress moves towards putting these protections in place, REALTORS® respectfully remind you that an appropriate balance must be struck between safeguarding the consumer and making sure consumers have access to mortgages at a reasonable cost. Undue regulation of the mortgage market that makes the sector unattractive for business participants will be as harmful to the consumer as the lack of regulation that allowed for the level of irresponsibility and abuse we have just experienced.

REALTORS® have a strong stake in preventing abusive lending, and have adopted a set of "Responsible Lending Principles" that form the basis for NAR's advocacy efforts in Congress. We are pleased that H.R. 1728 embodies the REALTORS® "Responsible Lending Principles"; therefore, REALTORS® offer strong support for H.R. 1728, "the Mortgage Reform and Anti-predatory Lending Act of 2009" because it strikes an appropriate balance between safeguarding the consumer and making sure consumers have access to mortgages at a reasonable cost.

Conclusion

Rarely do foreclosure "rescue" scams turn out with a happy ending. Rather, the "rescue" scenario that is played out over and over in communities across this country is in reality the theft of a family's wealth, the taking of a homeowner's dignity and stolen homeownership. For Americans who rely on their home as the foundation of their net worth, a foreclosure is emotionally and financially crippling.

REALTORS® help families achieve the dream of homeownership. The National Association of REALTORS® supports increased consumer protections to ensure that the "dream" our members help fulfill does not turn into a family's worst nightmare. NAR stands ready to work with Congress on the important issue of foreclosure "rescue" scams. Thank you.

TESTIMONY OF MASSACHUSETTS ATTORNEY GENERAL MARTHA COAKLEY COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

Wednesday, May 6, 2009

Foreclosure Rescue Fraud Legislation is Vital to the Protection of Vulnerable Homeowners

Good morning Chairwoman Waters and members of the Subcommittee. My name is Martha Coakley and I serve as Attorney General of the Commonwealth of Massachusetts. Thank you for giving me the opportunity to testify on H.R. 1231 and the important issue of protecting homeowners from loan modification and foreclosure rescue fraud. While I have some concerns about H.R. 1231 as originally filed, I support the amendment offered by Congresswoman Gwen Moore, and urge you to adopt it so that consumers will be further protected from foreclosure rescue fraud.

Our office is working diligently to combat predatory lending practices.

The Massachusetts Attorney General's Office is committed to combating predatory lending practices that have become prevalent during the mortgage foreclosure crisis that has gripped our nation. In Massachusetts, as in many parts of the country, we have experienced a dramatic surge in home mortgage foreclosures, due in large measure to unsound and predatory lending practices. Many foreclosures and delinquencies have resulted from loan practices and products that were destined to fail because lenders departed from the bedrock lending principle that one should reasonably assess the borrower's ability to repay before lending money.

In response, our office has sought accountability through regulation, litigation and other advocacy. In June 2007, our office enacted emergency regulations which govern mortgage lenders and mortgage brokers in Massachusetts in order to prevent predatory lending. These regulations

significantly extended the applicability of the regulations to purchase-money and refinance mortgage loans, and have been effective in protecting consumers in this area.

We have also brought enforcement actions against subprime lenders who promoted and originated risky loans, mortgage professionals who engaged in loan application fraud, and attorneys, brokers, and loan modification assistance companies who have preyed upon homeowners facing foreclosure. For example, our office filed suit against two major subprime lenders—Fremont Investment & Loan/Fremont General, and H&R Block/Option One Mortgage Corporation for predatory lending practices. In both actions, we obtained injunctions that restricted foreclosures on certain loans that were considered doomed to foreclosure because of the specific combination of ultra risky loan features that the lenders used in marketing these loans to consumers. In the Fremont case, the Massachusetts Supreme Judicial Court upheld the trial court's injunctive order, and the concept that it is an unfair trade practice to sell mortgage loans that require borrowers to refinance when the terms and conditions of the loan make refinancing virtually impossible to obtain, absent a perpetual increase in home values. In addition, we brought enforcement actions against mortgage professionals who engaged in loan application fraud, and other loan origination misconduct.

Our office is also working to protect consumers from foreclosure rescue schemes that have resulted from predatory lending practices.

Congresswoman Moore's amendment to H.R. 1231 will be a vital tool for law enforcement in combating foreclosure rescue schemes. As the proliferation of risky loan practices led to skyrocketing foreclosure rates, Massachusetts saw increasing numbers of homeowners targeted by unscrupulous parties trying to capitalize upon the foreclosure crisis. This fraudulent activity includes: 1) those attempting to convince desperate homeowners to transfer ownership of their homes, and 2) those charging upfront fees with a faulty promise to help homeowners obtain loan modifications.

These foreclosure relief fraud schemes can result in a homeowner losing money and in some instances, even their home. The first scheme involves a person or business that claims to be able to assist consumers facing foreclosure by promising replacement mortgage financing. When the foreclosure is imminent, however, the rescue schemer convinces the homeowner that they must convey their property to another purchaser in order to "save" their homes. As part of the scheme, the scam artist then arranges a mortgage loan in the name of a "straw" buyer. The real homeowner remains in the home for a period of time and pays rent, with a promise that they can re-acquire the home at a certain date in the future. Inevitably, the promise of maintaining home ownership is illusory and homeowners eventually lose their home to the so-called "rescuer." Even more tragic, however, is that whatever equity the homeowner once had in the property is often stripped away in the process and paid to the rescuer or some other third party. Our office has brought several enforcement actions to stop this type of foreclosure relief scheme.

The second most common type of scheme involves companies seeking to make a quick profit by claiming to help consumers obtain loan modifications. These companies reach out to desperate homeowners with promises to save their homes, and dramatically lower their interest rates. In Massachusetts, we have seen these entities advertising through mail, email, unsolicited telephone calls to homeowners, as well as through the newspaper, television, and radio. The advertisements often overstate guarantees, promising to save the home with a near 100% rate of success, or to achieve a loan modification with a new, eye-catching low rate. They often make false claims of affiliation with a government program, or claim to have lawyers on staff to aid the homeowner. Most alarming, these entities often solicit an upfront fee—ranging anywhere from one to several thousands of dollars.

The amendment to H.R. 1231 protects consumers against foreclosure rescue fraud.

In order to guard against those foreclosure consultants who are not reputable, our office enacted regulations to protect consumers against foreclosure rescue fraud. In June, 2007, we issued emergency regulations, which became final in August 2007. The regulations prohibit various unfair and deceptive acts, including: offering or carrying out predatory, for-profit foreclosure rescue transactions that result in the transfer of interest in the property; the solicitation or acceptance of an advance fee in connection with offering or providing services to help a homeowner avoid foreclosure; and the advertisement of foreclosure rescue services without clearly and conspicuously disclosing the precise services offered by the promoter and how the promoter will assist persons to avoid foreclosure.

Upon enactment of these regulations, our office brought several enforcement actions against companies and individuals who were preying upon homeowners facing foreclosure by engaging in conduct prohibited by the Massachusetts regulations. In December 2008, my office brought an enforcement action against an individual who was offering to help homeowners save their homes from foreclosure by assisting them in filing for bankruptcy in exchange for a $1,000 cash upfront fee. In many instances, the bankruptcy petitions were deficient and dismissed because they were incomplete or lacked the proper information. Our office obtained a preliminary injunction prohibiting the individual from contacting individuals to offer foreclosure related services or assisting individuals with filing for bankruptcy.

Our office also recently filed two cases against companies that were soliciting Massachusetts homeowners with misleading promises to save homes from foreclosure, and were soliciting and accepting illegal advance fees, in violation of our regulations. One such case against Express Modifications, Inc., involved a company running full-page advertisements, in Boston and New York newspapers, offering the services of a company they called "Loan Mods By Lawyers" to

save homes from foreclosure. The company demanded up front fees of $1,500 to assist homeowners in obtaining loan modifications and had no attorneys on staff. Upon filing our action against Express Modifications, we obtained a Temporary Restraining Order against the company enjoining its fraudulent foreclosure rescue activities. Shortly thereafter, we filed a Consent Judgment, which permanently enjoined the company from future operations in Massachusetts, and required the company to pay $7,300 in restitution to Massachusetts homeowners and $25,000 in civil penalties.

In combating these abuses, the Massachusetts regulations have been a vital enforcement tool. However, each week our office learns of new abuses stemming from the foreclosure crisis, many of them coming from outside of the state. As a result, H.R. 1231, as amended, is necessary to stop those who seek to benefit from the misfortune of others during this crisis.

As originally filed, H.R. 1231 raises several concerns. For example, it exempts both attorneys and real estate brokers from the definition of foreclosure consultant, thereby exempting them from the limitations designed to protect the property and security of homeowners. This is problematic because our enforcement actions have demonstrated that some attorneys and real estate brokers are participating in the type of unscrupulous conduct that this legislation is designed to prevent. While a competent and ethical attorney can be a valuable asset to a homeowner trying to avoid foreclosure, attorneys should be held to the same standards as any other parties in being proscribed from transferring property to themselves, or charging upfront or excessive fees for foreclosure rescue services.

We support the amendment to H.R. 1231 because it eliminates these exemptions, and still allows attorneys to collect an advance fee or retainer for legal fees in connection with the preparation and filing of a bankruptcy petition or court proceedings to avoid a foreclosure. This

language is similar to our state regulations which we have seen to be quite successful in curtailing this fraudulent activity. In addition, unlike the original bill, the amendment includes language addressing loan modifications, short refinancing and repayment plans in the scope of services performed by a "foreclosure consultant." Making this type of activity subject to the legislation is critical because our office has seen a noticeable increase in the amount of fraudulent activity involving these forms of mortgage rescue activities.

If enacted, the amendment to H.R. 1231 will serve an important role in combating the types of fraud I have outlined in my testimony. First, the amendment prohibits foreclosure consultants from acquiring any interest, directly or indirectly, in the residence of a homeowner with whom the foreclosure consultant has contracted. With appropriate enforcement, this provision should protect homeowners from the scams I addressed previously, that are aimed at transferring the home into the hands of the fraudsters.

Second, the amendment outlaws the collection of advance fees that have become so prevalent, by requiring, in Section 703(a)(1) that foreclosure consultants fully perform their services before they may demand or collect a fee. That section provides further, important protection, by stating that a fee cannot be collected at all if the end result of the service is that the homeowner's monthly mortgage payment has *increased.*

In addition, I respectfully recommend the amendment be further revised to reduce the allowable fees foreclosure consultants may charge. As drafted, section 703(a)(2) of the amendment, permits a fee equal to the greater of 1 percent of the principal outstanding balance on the property, or the sum of two monthly mortgage payments. Our experience has shown us that the second prong will often be the greater of the two. As such, if a homeowner facing foreclosure is unable to make their monthly mortgage payments, or is in imminent danger of falling behind on their mortgage

payments, we are concerned they will be likewise unable to afford to pay a fee equal to two months' payment, which in some instances, may be as much as six thousand dollars. This places the homeowner even further in financial straits, when it is intended to aid them in obtaining a sustainable loan modification. Given these concerns, we respectfully ask the Subcommittee to consider a more reasonable cap on fees.

Lastly, the amendment gives states the authority to bring an action under the federal law, or to enforce state laws which provide equal or greater protection, without preemption. This is critical, and we look forward to working with the federal government to utilize all the tools at our disposal, to protect homeowners from these disturbing trends.

Meaningful loan modifications continue to be the cornerstone in addressing the mortgage foreclosure crisis.

I continue to assert, and have done so in front of Congress on several occasions, that a significant portion of foreclosures should be avoided through loan modifications. However, most homeowners should be able to obtain a loan modification without having to hire someone to assist them or paying an upfront fee. Based on evidence our office has seen over the past several months, not all lenders and servicers are engaging in meaningful loan modifications, using a net present value analysis, in order to arrive at an affordable monthly payment for the homeowner. Additionally, we are hearing from distressed homeowners that inadequate staffing by the loan servicers has led to ineffective management of call volumes, poor customer service and ultimately in many instances, deficient loan modifications or none at all. This is significant because if servicers improved their customer service, fewer homeowners would feel the need to reach out to some of these third party entities for assistance in saving their homes from foreclosure.

Homeowners are facing mounting challenges as the foreclosure crisis continues and increased fraudulent rescue schemes emerge. This proposed legislation is an important step towards

providing solutions to these challenges and ending this fraudulent conduct. If H.R. 1231, as amended, is enacted, those who seek to prey upon vulnerable homeowners with unscrupulous conduct will be held accountable for their fraudulent behavior. Thank you for the opportunity to be heard on this critical matter, and we look forward to continuing to work with the Subcommittee on this important issue.

SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

OF THE COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

"LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD"

MAY 6, 2009

2128 RAYBURN HOUSE OFFICE BUILDING

10:00 a.m. to 2:00 p.m.

Testimony of

Scott J. Drexel
Chief Trial Counsel
The State Bar of California

Madam Chairwoman and Honorable Members of the Subcommittee on Housing and Community Opportunity:

Thank you for the opportunity to appear before your Subcommittee today and to address the California State Bar's perspective on loan modification and foreclosure rescue fraud.

My name is Scott Drexel. I am the Chief Trial Counsel of the State Bar of California. California has a total of more than 225,000 lawyers, more than 165,000 of whom are active members and entitled to practice law in our State. Approximately one of every seven attorneys in the United States is a California attorney.

My Office is responsible for the investigation of complaints against California attorneys and for the disciplinary prosecution of those attorneys who have violated our Rules of Professional Conduct or our State Bar Act.

Typically, my Office receives about 75,000 telephone calls to our toll-free complaint line and more than 15,000 written complaints about the conduct of lawyers.

Since approximately November 2008, telephone calls to our toll-free telephone lines have increased by more than 15 percent and we have received an average of nearly 900 telephone calls per month on the subject of loan modification and foreclosure rescue fraud, an annual rate of more than 10,000 telephone calls on this subject alone.

Clearly, this is a problem of extremely significant -- if not crisis -- proportions in California. The problem is so serious that, in February 2009, the California State Bar's Committee on Professional Responsibility and Conduct issued an "Ethics Alert," warning California attorneys and the public of the dangers of foreclosure rescue and loan modification fraud and to remind California attorneys of ethics rules that may impact their involvement in these matters.

In response to the large number of written complaints received by my Office on this subject, we have created a staff task force to focus solely on complaints of foreclosure rescue and loan modification fraud. We are working extensively in cooperation with other agencies to address the issues, especially the California Department of Real Estate, which regulates mortgage foreclosure consultants in California.

We have been proactive in our response to the suspected involvement of California attorneys in foreclosure rescue and loan modification fraud.

Pursuant to our statutory authorization, in March 2009, we successfully petitioned a California superior court to assume jurisdiction over the practice of a California attorney who was engaged in suspected loan modification fraud. Pursuant to court order and with the assistance of local law enforcement, we seized more than 2,300 of the attorney's client files, downloaded records from his computers, froze his client trust and office bank accounts and redirected his telephones and mail delivery to the State Bar's offices. We are in the process of returning files and advanced fees to the attorney's clients and assisting them in redirecting them to legitimate practitioners and others for help.

We have attacked the accuracy and propriety of attorney print, radio, television and Internet advertisements for loan modification services. Under California's Rules of Professional Conduct, attorneys are prohibited from making false, misleading or deceptive statements in advertisements and can neither make guarantees of success or advertise past successes without appropriate disclaimers and without having evidence to demonstrate the accuracy of those claims. In those cases where we suspect violations of our advertising rules, my Office has demanded the production of copies of all of the attorney's or law firm's advertisements, along with documentary evidence substantiating the accuracy of their claims. Our goal is to force the removal of all false or misleading advertisements from the print, radio and television media, thereby making it more difficult for unethical practitioners to prey upon members of the consuming public.

We have initiated more than 175 active investigations of attorneys suspected of engaging in foreclosure rescue and loan modification fraud. We are especially targeting those practitioners against whom we have received multiple complaints or who appear to be particularly egregious in their victimization of consumers.

On Thursday, May 7, 2009, we will be meeting with representatives of the United States Attorney's Office in Los Angeles, the California Attorney General's Office, the Department of Housing and Urban Development, the Federal Trade Commission, the California Department of Real Estate, the Los Angeles District Attorney's Consumer Fraud Unit and others to share information, coordination investigations and develop a comprehensive strategy for attacking these fraudulent practices.

In light of our experience to date, I will attempt to respond to some of the specific issues and questions posed by your Subcommittee.

- **What are the most common types of foreclosure rescue fraud?**

To date, the most common type of foreclosure rescue fraud that we have encountered, both by attorneys and by non-attorneys, have been false promises to consumers through advertisements that they can successfully negotiate with lenders to modify their mortgages, adjust their mortgage interest rates and reduce their monthly mortgage payments. The most crucial aspect of their fraud is to obtain an advance payment from the consumer of amounts ranging from $2,500 to more than $10,000. The foreclosure consultant, attorney or organization then fails to take any effective action on the consumer's behalf.

- **How will H.R. 1231 be effective in preventing foreclosure rescue fraud? In what ways can the legislation be improved in this regard?**

H.R. 1231 will provide significant assistance in preventing foreclosure rescue fraud by (a) prohibiting foreclosure consultants from demanding or receiving any advance payments from a homeowner until the consultant has fully performed each of the promised or agreed upon services and by prohibiting them

from either acquiring an interest in the homeowner's property or obtaining a power of attorney from the homeowner; and (b) requiring loan servicers to notify homeowners of the dangers of fraudulent activities associated with foreclosure and to direct them to the Department of Housing and Urban Development for assistance in avoiding foreclosure.

H.R. 1231 currently excludes attorneys, licensed real estate brokers and salespersons and others from the definition of "foreclosure consultant." While real estate brokers and salespersons in California are not permitted to request or received advanced fees after a Notice of Default has been recorded and may only receive advanced fees prior to that date with the specific approval of the California Department of Real Estate, attorneys in California are permitted to request and receive advanced fees. Moreover, unlike many other states, California attorneys are not required to deposit advanced fees in their client trust accounts and to only remove those fees from trust as services are performed. Rather, California attorneys may treat the advanced fees as their own funds, with the caveat that, if the client terminates the attorney prior to the time that the attorney has earned all of the advanced fees or a dispute develops over whether the attorney has earned the entire amount of the advanced fees, the attorney has an obligation to deposit and maintain the disputed funds in his or her client trust account until the dispute is resolved.

The ability of attorneys to request and receive advanced fees has encouraged many non-attorney foreclosure consultants to seek either the knowing or largely unwitting involvement of attorneys in their mortgage foreclosure scams. The consumer is falsely promised that the foreclosure rescue or loan modification services are being provided under the guidance of an attorney and advanced fees are requested and received under the guise of a legitimate attorney-client relationship. The attorney then receives a portion of the advanced fees, with the remainder being retained by the foreclosure consultant.

H.R. 1231 can be improved by finding an effective means to prohibit such conduct by attorneys, especially when working in conjunction with non-attorney foreclosure consultants.

- **How effective has California state legislation been in preventing foreclosure rescue fraud? How should federal legislation complement or build upon state efforts?**

California has regulated mortgage foreclosure consultants by legislation since 1979. (Calif. Civ. Code, §§ 2945, *et seq.*) Among other things, the Mortgage Foreclosure Consultants Act has prohibited foreclosure consultants from receiving advanced fees for services after a Notice of Default has been recorded, requires contracts between foreclosure consultants and homeowners to be in writing and prohibits the foreclosure consultant from obtaining any direct or indirect interest in the homeowner's property.

However, what the California legislation has lacked is an effective enforcement mechanism. The California Department of Real Estate ("DRE") oversees the activities of mortgage foreclosure consultants. While the DRE has the authority to issue "desist and refrain" letters to foreclosure consultants who violate the provisions of the Act, they must rely upon the local district attorneys for any criminal prosecution.

There is legislation currently pending in California that would assist in combating foreclosure rescue and loan modification fraud. If enacted, Senate Bill 94 would broaden the prohibition against receiving advanced fees to all individuals engaged in loan modification services, including attorneys. It would also require individuals engaged in loan modification services to provide specific warnings to homeowners and to notify them that there are free counseling and borrower assistance services available from a list of nonprofit housing counseling agencies approved by the Department of Housing and Urban Development.

While both the current Mortgage Foreclosure Consultants Act and the proposed provisions of S.B. 94 provide important protections for the homeowner from fraudulent activities of foreclosure consultants, attorneys and others, the key to resolving this crisis is an effective enforcement mechanism, either through criminal prosecutions or through injunctive relief.

- **In what way does state legislation regulate loan modification companies that charge fees to homeowners who may not have missed any payments? How should Federal legislation address these kinds of companies?**

In California, mortgage foreclosure consultants are permitted to receive advanced fees for services if no Notice of Default has been recorded. However, there must be a written agreement between the foreclosure consultant and the homeowner that specifies the services to be provided and, most critically, the agreement for advanced fees must be reviewed and approved in advance by the California Department of Real Estate. Moreover, foreclosure consultants who are authorized by DRE to receive advanced fees from the homeowner must deposit and maintain those fees in a trust account and may only remove the fees as they are earned.

Any federal legislation enacted in this area should be consistent with these provisions of California law.

- **How are some attorneys and real estate brokers complicit in loan modification and foreclosure rescue fraud?**

Attorneys have been complicit in loan modification and foreclosure rescue fraud in several respects. The key component of their involvement in fraudulent activities is their ability to demand and receive advanced fees for services.

Regrettably, a certain number of attorneys are willing to engage in these fraudulent activities on their own.[1] In many cases, however, attorneys are approached by non-attorney foreclosure consultants who seek to work in concert with them. In exchange for the use of the attorney's name and his or her ability to charge and receive advanced fees, the foreclosure consultant typically offers to perform most or all of the loan modification services and promises to either

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[1] In one particularly egregious case, the attorney and the foreclosure consultants with whom he is working have talked homeowners into providing them with bank account information before the homeowner has even signed an agreement retaining the attorney for loan modification services. The attorney then electronically withdraws funds from the homeowner's bank account without any prior notice or authorization from the homeowner and before the homeowner has even decided to retain the attorney.

pay the attorney a specified amount for each loan modification or to provide an agreed-upon percentage of the fees received from the homeowner.

The foreclosure consultants often prey upon new attorneys who are unaware of their ethical responsibilities and who, in the current economy, are having problems in attracting sufficient legal business. These consultants also appear to prey upon older attorneys who cannot afford to retire but who no longer have the energy or ability to maintain a large law practice by offering them a steady monthly income to supplement what the attorney can earn through his or her legitimate law practice.

Besides the fraudulent aspect of the activities themselves, these arrangements violate numerous provisions of California's Rules of Professional Conduct. For instance, rule 1-310 of the Rules of Professional Conduct prohibits a member of the State Bar from forming a partnership with a person who is not a lawyer if any of the activities of the partnership consist of the practice of law.

Similarly, rule 1-320 prohibits a member or a law firm from directly or indirectly sharing legal fees with a person who is not a lawyer, with exceptions that are not applicable to the alleged services to be provided by foreclosure consultants.

Additionally, members of the State Bar have a duty to obey and support the constitution and laws of the United States and of the State of California. (Calif. Bus. & Prof. Code, § 6068, subd. (a).) Acts of the attorney that aids or abets the violation of the Mortgage Foreclosure Consultants Act or other provision of law constitutes a violation of section 6068, subdivision (a).

- **How are some attorneys and real estate brokers useful in preventing loan modification and foreclosure rescue fraud?**

The vast majority of attorneys in California are ethical practitioners who are dedicated to providing quality legal services to their clients. Attorneys who are actively engaged in providing legitimate loan modification services to their clients have been willing to report to both the State Bar and the Department of Real Estate suspected fraudulent activities by attorneys and non-attorneys. They

have also reported to the State Bar that they have been repeatedly approached by non-attorney foreclosure and loan modification consultants interested in using their law licenses to receive advanced fees and offering to share fees received from consumers.

Many attorneys have also provided free legal advice and services to homeowners whose homes are in foreclosure or who are seeking to modify existing mortgage loan agreements.

- **What types of fees are typically charged by foreclosure consultants and loan modification companies? In what ways are these fees excessive?**

In the cases that the California State Bar has been investigating, we have typically encountered advanced fees for loan modification services ranging from approximately $2,500 to more than $10,000, with the average fee in the range of about $3,000 to $4,000.

In most of the cases that the State Bar is investigating, the attorney and/or the foreclosure consultant perform few, if any, services in exchange for these advanced fees. In essence, these monies have been obtained from homeowners under false pretenses. At most, in exchange for these advanced fee payments, the attorneys or foreclosure consultants make a few, largely ineffectual, telephone calls to the financial institution that holds the mortgage.

I hope that the information I have provided is helpful to your Subcommittee's consideration of this important legislation and to seeking effective means of addressing and preventing foreclosure rescue and loan modification fraud.

Thank you again for the opportunity of sharing the experience of the State Bar of California in dealing with these serious problems.

Statement of James H. Freis, Jr, Director
Financial Crimes Enforcement Network
United States Department of the Treasury

Before the United States House of Representatives
Committee on Financial Services
Subcommittee on Housing and Community Opportunity

May 6th, 2009

Chairwoman Waters, Ranking Member Capito, and distinguished members of the Subcommittee, I am Jim Freis, Director of the Financial Crimes Enforcement Network (FinCEN), and I appreciate the opportunity to appear before you today to discuss FinCEN's work in combating mortgage loan fraud and our role in the Administration's effort to address the current foreclosure rescue fraud problem. It is more important than ever for our government to be particularly vigilant in this regard, as the downturn in our economy and the government's efforts to improve conditions through the Financial Stability Plan have also created opportunities for those who resort to fraud.

FinCEN has unique contributions to make in this regard, as the authorities that we have been given by the Congress place us at the intersection of the law enforcement and regulatory communities and the financial industry. My testimony today will focus on a number of our ongoing strategic initiatives in the broad mortgage market under which our authorities are maximized to assist in the prosecution of fraudulent actors and to prevent the proliferation of such crimes.

Background on FinCEN

FinCEN's mission is to safeguard the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit financial activity. FinCEN works to achieve its mission through a broad range of interrelated strategies, including:

- Administering the Bank Secrecy Act (BSA) - the United States' primary anti-money laundering/counter-terrorist financing regulatory regime

- Supporting law enforcement, intelligence, and regulatory agencies through the sharing and analysis of financial intelligence
- Building global cooperation and technical expertise among financial intelligence units throughout the world.

To accomplish these activities, FinCEN employs a team comprised of just over 300 dedicated Federal employees, including analysts, regulatory specialists, international specialists, technology experts, administrators, managers, and Federal agents who fall within one of the following mission areas at FinCEN:

Regulatory Policy and Programs - FinCEN issues regulations, regulatory rulings, and interpretive guidance; assists State and Federal regulatory agencies to consistently apply BSA compliance standards in their examination of financial institutions; and takes enforcement action against financial institutions that demonstrate systemic non-compliance. These activities span the breadth of the financial services industries, including – but not limited to – banks and other depository institutions; money services businesses; securities broker-dealers; mutual funds; futures commission merchants and introducing brokers in securities; dealers in precious metals, stones, or jewels; insurance companies; and casinos.

FinCEN's regulations serve essentially two purposes. First, we require financial institutions to be vigilant against criminal abuse by illicit actors trying to defraud the institution or its customers or to advance their criminal purposes by moving tainted funds through the legitimate financial system. Second, the recordkeeping and reporting obligations create a trail for law enforcement to literally "follow the money" in the investigation and prosecution of criminals. The two most prominent types of reports are those involving large amounts of cash (Currency Transaction Reports or "CTRs") which would otherwise be unreported, and Suspicious Activity Reports ("SARs"), where the well-trained eye of the financial institution can help us sort out legitimate economic activity from possible criminal activity.

Analysis and Law Enforcement Support – FinCEN provides Federal, State, and local law enforcement and regulatory authorities with different methods of direct access to SARs, CTRs and other reports submitted by financial institutions pursuant to the BSA. FinCEN also combines BSA data with other sources of information to produce analytic products supporting the needs of law enforcement, intelligence, regulatory, and other financial intelligence unit customers. Products range in complexity from traditional subject-related research to more advanced analytic work including geographic assessments of money laundering threats.

International Cooperation – FinCEN is one of more than 100 recognized national financial intelligence units (FIUs) – a central government agency like FinCEN that collects, analyzes, and disseminates financial information to investigate and prosecute criminal activity. We coordinate activities with our FIU partners around the globe largely through a formal organization known as the Egmont Group, an essential focus being the sharing of lead information involving criminal activity that crosses national borders.

FinCEN plays a lead role in fostering international efforts to combat money laundering and terrorist financing among these financial intelligence units, focusing our efforts on intensifying international cooperation and collaboration, and promoting international best practices to maximize information sharing.

FinCEN Focus on Mortgage Fraud

FinCEN first focused on analyzing trends and patterns related to mortgage fraud back in 2002 in the context of an effort to identify areas of potential concern in the sales and management of real estate. Since that time, still within a robust housing market, it became apparent that our SAR data was a leading indicator that mortgage loan fraud was a serious, escalating problem. In our November 2003 SAR (Suspicious Activity Report) Activity Review, we published some of the results of two related FinCEN strategic analytical studies focused on SARs reported in 2001 and 2002.

For that period, overall suspected fraudulent activity was only a small portion of the suspected illegal activity in connection with real estate transactions. Even among a relatively small sample, however, we noted that mortgage fraud was the predominant reported concern. We also explained the few instances of "flipping," defined as "the buying and selling of the same property within a short period of times with the intention of making a quick profit," warning that flipping activity is often coupled with mortgage fraud and other forms of fraud.[1]

As we continued to follow the trends in SAR reporting from 2003 into 2004, FinCEN analysts noted a dramatic increase in the number of filings indicating suspected mortgage fraud, leading us to drill down more closely into this area.

For our first detailed study focusing exclusively on mortgage fraud, published in November 2006[2], we proceeded to go back to take a closer look at all of the mortgage fraud filings since the inception of the SAR reporting requirements, analyzing ten years of mortgage fraud reporting data nationwide. Depository institutions filed 82,851 SARs describing suspected mortgage fraud between April 1, 1996 and March 31, 2006. SARs pertaining to mortgage fraud increased by 1,411 percent in the nearly a decade between 1997 and 2005, compared to a 543 percent increase for SARs overall.

In the November 2006 study we explained a range of fraudulent schemes in an effort to provide the financial industry with "red flag" indicators that could help them protect their financial institutions and their customers from being victims of fraud. The report detailed that material misrepresentation/false statements were reported on approximately 2/3 of reports, and noted the vulnerabilities posed by automated processing and low documentation/no documentation loans. The report also explained that mortgage fraud can be divided into two broad categories:

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[1] *See* http://www.fincen.gov/news_room/rp/files/sar_tti_06.pdf (pages 31-36)
[2] *See* http://www.fincen.gov/news_room/rp/reports/pdf/mortgage_fraud112006.pdf

- *Fraud for property* – homebuyers misrepresenting income or assets to purchase homes for personal use (approx. 2/3 of sample); and
- *Fraud for profit* – perpetrator intends to abscond with proceeds, with little or no intention to occupy the property; often committed with the complicity of industry insiders (approx. 1/3 of sample).

Since the publication of our first study in November 2006, FinCEN analysts have engaged in nearly 40 formal training events – in addition to other numerous speaking and outreach opportunities by FinCEN leadership - to educate the financial, regulatory and law enforcement communities.

FinCEN also published reports based on SAR analysis that indicated how proceeds of crime generally, although not necessarily connected to mortgage fraud, may be laundered through investments in commercial real estate[3] and residential real estate.[4] These reports, issued in December 2006 and April 2008, respectively, added to the earlier discussion of money laundering vulnerabilities from the 2003 SAR Activity Review report.

FinCEN issued its second study in the mortgage fraud area in April 2008, which provided an update of fraud schemes, with more details on complicit insiders.[5] A key finding was a 50 percent increase in SARs that reported intercepting the suspected fraud prior to funding a mortgage (an indication of growing vigilance and awareness in the financial community). The report also noted that the total for mortgage fraud SARs filed reached 52,868, an increase of 42 percent from the previous year.

In February of this year, FinCEN issued its third strategic analytical report in the mortgage fraud area.[6] Our third report looked at 62,084 SARs reporting mortgage fraud, the third most reported type of suspicious activity (following only BSA/structuring/money laundering, and check fraud). Filings had increased 44 percent from 43,000 the prior year.

A new trend that FinCEN spotted in that third round of analysis was the increase in mortgage fraud detection in connection with mortgage purchasers sending home loans back to originators for repurchase. Filing institutions referenced repurchase demands in 8 percent of filings. FinCEN also found that filing institutions referenced foreclosures in 13 percent of their SAR filings, insurers in 8 percent and early default payments in 2 percent of filings as indications of suspected fraud. These patterns of filings generally involved the detection of suspected fraud after the mortgage had been granted. That notwithstanding, there also was an increase in the percentage of SARs filed prior to granting the loan – 34 percent compared with 31 percent in the prior one-year period. In FinCEN's April 2008 report, the increase was 21 percent over the preceding decade. Once again, this reaffirmed the trends we had been seeing since we began examining this issue, and also indicated a growing vigilance and awareness within the financial industry.

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[3] *See* http://www.fincen.gov/news_room/rp/reports/pdf/CREassessment.pdf.
[4] *See* http://www.fincen.gov/news_room/rp/files/MLR_Real_Estate_Industry_SAR_web.pdf.
[5] *See* http://www.fincen.gov/news_room/rp/files/MortgageLoanFraudSARAssessment.pdf.
[6] *See* http://www.fincen.gov/news_room/nr/pdf/20090225a.pdf.

FinCEN's fourth and most recent detailed analytical publication focusing on mortgage fraud was issued in March of this year.[7] That analysis showed that thousands of subjects reported by depository institutions for suspected mortgage loan fraud were also reported by at least one other type of financial institution -- money services business, securities broker and dealer, insurance company, and casino and card club – for suspicion of being involved in other financial crimes such as check fraud, money laundering, stock manipulation, structuring to avoid currency transaction reporting requirements and others. The interconnected nature of suspicious activity across multiple financial sectors covered by FinCEN's regulations as revealed in this study underscores the immense value of combining insights from the different sectors for the purpose of detecting and thwarting criminal activity.

In calendar year 2008, the total number of SARs filed related to mortgage fraud was 64,816, an increase of 22.6% over the previous year. This increase does not necessarily reflect a continuing rise in the amount of fraud in the mortgage industry. A large portion of the filings represent fraud in the original mortgage fraud application that was only uncovered months or years later when a mortgage went into default. FinCEN's analysis in this area is ongoing, and we will continue to make public relevant findings to help the financial industry protect itself and its customers from becoming victims of fraud, while we also continue to support law enforcement efforts to hold criminals accountable.

Additional Law Enforcement Support Provided by FinCEN

While the above information illustrates FinCEN's proactive analytical work on mortgage loan fraud, it is just one component of our dedication to this issue. A second involves our efforts in close cooperation with criminal investigators and prosecutors to hold accountable those persons engaged in criminal activity.

On an interagency basis, FinCEN is actively involved with a number of initiatives that focus on combating fraud: The Bank Fraud Working Group and the Mortgage Fraud Working Group, sponsored by the Department of Justice, and the President's Corporate Fraud Task Force which is run out of the Department of Justice. FinCEN staff regularly briefs the Mortgage Fraud Working Group on our latest mortgage fraud trends and patterns and we have hosted the Bank Fraud Working Group for discussions on the issue. FinCEN also provides technical advice and analytical support to prosecutors at the Federal and State levels.

In addition to the published analytical reports, FinCEN provides both strategic and tactical support to the law enforcement and financial regulatory communities to investigate and prosecute fraud. For instance, we have supported the FBI in their investigations in the mortgage fraud area, providing information to their Financial Crimes Intelligence Unit to assist in identifying potential investigative targets.

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[7] *See* http://www.fincen.gov/news_room/rp/files/mortgage_fraud.pdf.

FBI Deputy Director John S. Pistole, in his recent Congressional testimony focusing on the FBI's mortgage fraud efforts, spoke to the importance of utilizing lead information from SARs in their efforts to combat fraud; and he also noted the many interagency efforts the FBI has underway with FinCEN and others to tackle mortgage fraud.[8]

FinCEN has provided analytical support to the FDIC in their work with problem institutions, where BSA data is proving very valuable to their investigations in the mortgage fraud area. Last summer, FinCEN also supported SEC efforts to identify potential securities fraud linked to mortgage fraud.

FinCEN is also partnering with numerous other Federal agencies in a broad, multi-agency task force headed by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), in coordination with the Inspector General for the Board of Governors of the Federal Reserve System. This proactive initiative combines law enforcement civil and criminal resources to deter, detect, and investigate instances of fraud in the Term Asset-Backed Securities Loan Facility (TALF). More broadly, we are working with Office of Inspector General (OIG) offices around the country to support their efforts to root out the waste, fraud, and abuse in a range of government programs.

On March 13th FinCEN entered into a Memorandum of Understanding (MOU) with SIGTARP that provides them direct access to Bank Secrecy Act (BSA) reports. FinCEN is also providing regular training to the SIGTARP staff on money flows and on how to effectively use BSA data for their analytical purposes, and is currently working with the SIGTARP's Investigations Division and Counsel to develop a joint advisory to send to financial institutions on reporting suspicious activity related to criminal use of TARP funds.

FinCEN is also providing the HUD-IG technical training and support to use BSA data in mortgage fraud cases and assisting them in a strategic effort to proactively identify mortgage fraud in FHA loans by generating leads and potential investigative subjects through SAR analysis. These leads will assist them by identifying potential fraud by industry insiders, finding mortgage fraud "hot spots," and reducing labor intensive research for investigators by centralizing and streamlining the identification of potential frauds as reported in SARs.

FinCEN has also facilitated requests from law enforcement through our PATRIOT Act section 314(a) program where law enforcement indicated that mortgage fraud was a component of their significant money laundering investigations. This is a unique authority provided by Congress that allows FinCEN to reach out to the financial industry to identify previously unknown bank accounts and transactions. These new leads often advance law enforcement investigations, including for the purpose of seizing and forfeiting criminal proceeds, some of which might be available for restitution for victims.

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[8] Pistole, John. Statement Before the Senate Judiciary Committee, Washington, D.C. 11 February 2009. *See* http://www.fbi.gov/congress/congress09/pistole021109.htm

The Administration's Response to Foreclosure Rescue Fraud

On February 18th, President Obama announced a series of initiatives to address the nation's housing crisis and help American homeowners. The Making Home Affordable programs were designed to keep mortgage rates low, allow responsible homeowners to refinance into affordable mortgages or alter at-risk loans and help homeowners lower their monthly mortgage payments. But just as the Administration intensifies its efforts to help American homeowners, those who would seek to prey on the most vulnerable are intensifying their tactics as well, often through purported "mortgage modification" and "foreclosure relief" companies.

On April 6th, Treasury Secretary Geithner, along with Attorney General Holder, Secretary of Housing and Urban Development Donovan, and Federal Trade Commission Chairman Leibowitz, announced a major interagency effort to combat foreclosure rescue scams. Two specific initiatives were included as the Treasury's primary efforts to the joint response.

First, FinCEN issued an advisory[9] to help financial institutions spot questionable loan modification schemes and report that information for law enforcement purposes. The advisory provides "red flags" for financial institutions that may indicate a loan modification or foreclosure rescue scam.

Second, the Treasury announced an advanced targeting effort - coordinated by FinCEN - to deter fraudulent activity and combat fraudulent loan modification schemes. FinCEN, working with our partners from the law enforcement and regulatory communities, is utilizing information provided by the financial industry, along with other information supplied by participating agencies, to identify possible loan modification fraud suspects for civil and criminal investigations. This research initiative uses SAR filings specifically related to loan modification/ foreclosure rescue to identify targets for referral to appropriate law enforcement authorities.

By serving as a networking and deconfliction center, FinCEN is also helping law enforcement agencies streamline and coordinate their efforts so that the resources of multiple investigative and prosecutorial agencies are focused in the most efficient way. This cooperative effort will maximize government resources to shut down fraudulent companies more quickly than before, target companies that otherwise would have gone unnoticed 'under the radar', and will increase our knowledge of how these companies operate, enhancing our efforts to identify and prosecute every individual involved in a mortgage rescue scam.

FinCEN is proactively reaching out to State-based organizations such as the National Association of State Attorneys General and National District Attorneys Association to involve their members in this initiative and to solicit input on their ongoing activities. While Federal criminal investigators and prosecutors are committed to pursuing the most

[9] http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2009-a001.pdf

egregious organized criminal actors, it is critical that we involve our State and local partners to avoid letting criminals slip below the radar screen. FinCEN can play a natural role here through its relationships not only with all major Federal law enforcement agencies and U.S. Attorneys' offices across the country, but also its longstanding support of State law enforcement coordinators in all fifty States, as well as police forces in many major municipalities.

We have also participated in Neighborworks-organized teleconferences with participants from Federal, State, local and non-profit organizations and followed up with a detailed memorandum on FinCEN's strategy and solicited input. Any feedback will only serve to complement FinCEN's proactive research initiative of Suspicious Activity Report filings specifically related to loan modification/ foreclosure rescue to identify targets for referral to appropriate law enforcement authorities.

Conclusion

FinCEN is proud to play its part in supporting the Administration's and the Treasury Department's broader efforts as part of the Financial Stability Plan, including the Making Home Affordable programs. While it is impossible to eliminate the possibility of abuse or fraud in broad fiscal stimulus programs, new efforts to spur economic growth and promote responsible homeownership should rightfully be accompanied by renewed vigilance to mitigate criminal tendencies that could undermine the effectiveness of these critical policy initiatives.

The cornerstone of prevention is having the appropriate intelligence for detection, and aggressive action at the earliest stages will make it more difficult for bad actors to engage in fraudulent activity. None of the analytical work FinCEN is doing to fight mortgage fraud and to curb the system of abuse that is exploiting our nation's housing rescue programs would be possible without the SARs, and other BSA reports, that financial institutions file. And those of us who receive and use this information have an important public trust to uphold. This is a responsibility the 300 men and women that make up FinCEN take very seriously. We greatly value our partnership with the financial industry to advance our shared goals of protecting against abuse of the financial system. Educating financial institutions and the general public about risks and vulnerabilities, and, where possible, using regulatory authorities to help mitigate them, will remain key components of our Government strategy to prevent financial crime.

Those who nonetheless violate the law should be held accountable. The law enforcement and prosecutorial resources of the Justice Department, the States, and consumer protection authorities such as the FTC are working hard to prosecute and shut down the unscrupulous opportunists who prey on the economic hardships of others. FinCEN will continue to seek to leverage its expertise, information, and longstanding relationships with a broad range of Federal and State, criminal and civil enforcement authorities, to promote the use of all available tools in furtherance of the objective that crime should not pay.

Thank you for inviting me here today. I am happy to answer any of your questions.

LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD

Subcommittee on Housing and Community Opportunity
House Financial Services Committee

May 6, 2009

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On behalf of:

Consumer Federation of America
Legal Aid Society of Milwaukee
National Association of Consumer Advocates
National Consumer Law Center (on behalf of its low income clients)
National Council of La Raza

LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION AND FORECLOSURE RESCUE FRAUD

Chairwoman Waters, Congresswoman Capito, Members of the Committee: thank you for inviting me to testify today on behalf of the low income clients of the National Consumer Law Center,[1] the Consumer Federation of America,[2] the National Association of Consumer Advocates,[3] the National Council of La Raza,[4] and the Legal Aid Society of Milwaukee.[5] I am here today expressing the frustrations of many that homeowners cannot get the help they desperately to modify their loans to avoid foreclosure, and are instead finding themselves in the arms of operations set up to take their money, not provide help.

I. INTRODUCTION

Homeowners facing foreclosure have always been vulnerable to scammers, con-artists, and thieves. When property values were appreciating rapidly, foreclosure rescue scams primarily focused on obtaining title to the home and robbing homeowners of their

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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 sixteen practice treatises and annual supplements on consumer credit laws, including Foreclosures (2d ed. 2007 & Supp. 2008) and Unfair and Deceptive Acts and Practices (7th ed. 2008). NCLC also publishes practice guides, such as Combating Foreclosure Rescue Scams: A Practice Guide (2006) and bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. This testimony was written by Lauren Saunders and Tara Twomey.

[2] The Consumer Federation of America (CFA) is a nonprofit association of some 300 pro-consumer groups, which was founded in 1968 to advance consumers' interests through research, advocacy and education.

[3] 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.

[4] The National Council of La Raza (NCLR) is the largest national Hispanic civil rights and advocacy organization in the United States. For the last ten years, NCLR has been helping Latino families become homeowners by supporting local housing counseling agencies. The NCLR Homeownership Network (NHN), a network of 51 community-based counseling providers, works with more than 40,000 families annually and produced more than 25,000 first-time homebuyers in its first decade. Last year, NHN members counseled more than 7,500 homeowners facing foreclosure.

[5] The Legal Aid Society of Milwaukee was founded in 1916 "to do all things necessary for the prevention of injustice." It is one of the nation's oldest, continuously operating, public interest law firms. Each year the Society provides free legal services to 8,000 of Milwaukee's most vulnerable residents: abused and neglected children, developmentally disabled adults, persons living with HIV/AIDS, battered women, immigrants, elderly, prisoners, mentally ill, physically impaired, unemployed, and homeless – all of whom are too poor to afford legal counsel.

equity.[6] Today with property prices depreciating and many homes already "underwater," equity is no longer the game.

Instead, rescuers have become high-volume, "loan modification specialists." The pitch by this new breed of predators is that, for a fee, which can reach several thousand dollars, they will negotiate a loan modification for a financially distressed borrower. The hitch is that the "work" performed, if any, leads nowhere, with the homeowner out money and time and closer than ever to foreclosure.

These loan modification companies are flourishing because mortgage loan servicers cannot or will not provide borrowers with timely and consistent information regarding their requests for loan modifications. Frustrated by the lack of responsiveness on the part of the servicers, borrowers across the country are giving loan modification companies their precious dollars with disastrous consequences.

The most important work that Congress can do to prevent these scams is 1) address the servicing problems that drive homeowners to scammers, 2) support legitimate loan modification efforts, and 3) expand funding for existing federal enforcement efforts. In addition, though many states have laws to address foreclosure rescue scams, Congress could adopt a strong national floor to protect homeowners in all states.

To address the root cause of the problem, Congress should:

- *Mandate Borrower Access to a Decision Maker at the Servicer*—Servicers must provide borrowers with contact information for a real person with the information and authority to answer questions and fully resolve issues related to loss mitigation activities for the loan.

- *Require Servicers to Engage in Reasonable Loss Mitigation*—Servicers' failure to engage in reasonable loss mitigation before proceeding to foreclosure drives desperate homeowners into loan modification scams.

- *Increase Funding for HUD-Approved Housing Counseling Agencies.*---These agencies are the only loan modification specialists with a proven track record, but they are overwhelmed and need more resources.

- *Increase Enforcement Funding for the FTC and other appropriate federal agencies.*---Prominent federal enforcement actions can have a significant deterrent effect, but they are time consuming. The spread of these scams deserves further resources to attack them.

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[6] National Consumer Law Center, *Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity Stripping Foreclosure 'Rescue' Scams* (June 2005).

Regarding loan modification scams themselves, many states have been active in enacting laws, but other states lag behind. As long as stronger state laws are not preempted, federal legislation could help send a strong, uniform national message that firms may not charge borrowers fees until homeowners receive long-term, affordable loan modifications. Effective legislation should include the following elements, with any federal legislation as a floor, not a ceiling:

- *Prohibit Up Front Payments for Foreclosure Consultant Services*—A ban on up front payments will curb the most egregious scams in which companies take large payments from borrowers and make no effort to obtain a loan modification on their behalf.

- *Require Affordable, Sustainable Loan Modifications*—Permit fees for loan modification firms only if the services lead to a sustainable, affordable loan modification.

- *Tie compensation to results achieved*—Fees should be commensurate with the benefit to the homeowner.

- *Avoid exemptions that open wide loopholes, while avoiding excessive restrictions on legitimate services.* Exemptions to advance fee requirements for mortgage and real estate brokers should not be necessary, as these brokers are typically paid only when a mortgage is obtained or a home sold. Attorneys should be generally exempt but the exemption should be drawn to avoid evasions for work by nonlaywers.

II. THE ROLE OF MORTGAGE SERVICERS: CUTTING COST, CUTTING SERVICE AND DRIVING BORROWERS TO FORECLOSURE RESCUE OPERATIONS.

The most obvious cause of the recent flood of foreclosure rescue scam operations is the foreclosure crisis. An estimated 8.1 million mortgages are anticipated to be in foreclosure within the next fours years.[7] These millions of desperate homeowners are a target too tempting to resist for scammers.

Beyond the numbers, however, foreclosure rescue scams are flourishing because those who actually are 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.

[7] Credit Suisse, *Foreclosure Update: over 8 million foreclosures expected*, at 3 (Dec. 4, 2008).

Despite widespread efforts to encourage voluntary loan modifications since early 2007,[8] the servicing industry[9] 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.

As with all businesses, servicers add more to their bottom line to the extent that they can reduce expenses. Servicers have cut costs by relying more on voicemail systems and less on people to assist borrowers, by refusing to respond to borrowers' inquires and by failing to resolve borrower disputes. Recent industry efforts to "staff-up" loss mitigation departments have been woefully inadequate.

From the homeowner's perspective one of the biggest obstacles to loan modification is finding a live person who can provide reliable information about the loan account and who has authority to make loan modification decisions. Stories abound of exasperated homeowners attempting to navigate vast voicemail systems, being bounced around from one department to another, and receiving contradictory information from different servicer representatives.[10] For example, an October 2007 survey from the Neighborhood Housing Services of Chicago found that "countless counselors shared stories of having a client in the office ready to begin dealing with long-deferred financial problems, but then having to wait 30 minutes or more in order to talk to an appropriate loss mitigation staff person."[11] Unfortunately, things have not improved as servicers struggle to keep up with the increased workload caused by the foreclosure crisis.[12]

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[8] 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), *available at* 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.

[9] Servicers are generally responsible for account maintenance activities such as sending monthly statements, accepting payments, keeping track of account balances, handling escrow accounts, calculating interest rate adjustments on adjustable rate mortgages, reporting to national credit bureaus, and remitting monies to the owners of the loans. Servicers also are responsible for engaging in loss mitigation activities and prosecuting foreclosures.

[10] *See, e.g.,* Gretchen Morgensen, *Can These Mortgages Be Saved?,* New York Times (Sept. 30, 2007)(describing one homeowner who identified 670 calls relating to her home foreclosure in the previous three months and who received nine different answers about how best to proceed from 14 different people at the company); *Miller v. McCalla,* Raymer, 214 F.3d 872, 875 (7th Cir. 2000)(describing the process of trying to get through to an 800 number as a "vexing and protracted undertaking").

[11] Neighborhood Housing Services of Chicago, Inc., *Lessons from the Front Lines: Counselor Perspectives on Default Intervention*, p.6 (Oct. 29, 2007).

[12] *See* Kate Berry, *The Trouble with Loan Repayment Agreements*, American Banker (Jan. 9, 2008) (noting that servicers push repayment plans instead of modifications because they "need twice the staff, and in part they can't manage the volume").

The Chairwoman of this Subcommittee, Congresswoman Maxine Waters, has demonstrated the difficulties faced by borrowers attempting to obtain a loan modification by making calls to servicers on behalf of three constituents.[13] In one call to Bank of America it took ten minutes to get a live person on the line, then the Congresswoman was transferred to another department, put on hold and eventually disconnected. A common fate according to her constituent, who noted that he had been repeatedly disconnected in prior attempts to contact the servicer. After two hours and three additional calls to Bank of America's call center, Congresswoman Waters still was unable to make much headway. The Congresswoman concluded that, "the average American trying to get through to negotiate a loan modification will not be able to get it done."[14]

The servicing industry's unresponsiveness to borrowers' inquiries and their 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."[15] If a homeowner is consistently disconnected or cannot wait on hold for 30 minutes because she has only a 15-minute work break maybe $1000 is not too much to pay for a chance to save her home. If a homeowner can't find his way out of the voice mail maze, maybe paying someone who can (or who claims to have special connections) seems like money well spent.

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 cement life jackets.

III. FORECLOSURE RESCUE SCAMS: FLOURISHING IN GOOD TIMES AND IN BAD

A. An Overview of Foreclosure Rescue Scams

Foreclosure rescue scams are not new. California passed a law to specifically address foreclosure rescue operations in 1979. By 2005, at the height of the housing boom, the scams were prevalent enough that we published a report, "Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure 'Rescue' Scams."[16]

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[13] ABC Nightline, *Congresswoman on Hold on Bank Helpline: Homeowners' attempts to fight foreclosure are hampered by bank call centers* (Jan. 22, 2009), available at http://abcnews.go.com/video/playerIndex?id=6704983.
[14] *Id.*
[15] Renae Merle, *Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say*, Washington Post, p. A01 (Dec. 26, 2008).
[16] Available at: http://www.nclc.org/issues/foreclosure/index.shtml.

These scams revolve around heavily-promoted deals supposedly designed to save the homes of people who have fallen behind on their mortgage payments and face foreclosure. But with frightening regularity "help" from "rescuers" drains off homeowners' scarce funds or built-up equity. In some cases, "rescuers" are left owning the houses – and families are eventually evicted from their homes. It is hard to escape the conclusion that such outcomes are exactly what the "rescues" are designed to achieve.

Our 2005 report described three varieties of foreclosure rescue scams. The first is "phantom help," where the "rescuer" charges outrageous fees either for light-duty phone calls and paperwork the homeowner could have easily performed, or on a promise of more robust representation that never materializes. Victims of phantom help are inevitably left without enough assistance to save their homes, without the funds diverted to the rescuers, and without time to pursue other options by the time they realize the rescue has not materialized. The "rescuer" essentially abandons homeowners to a fate that might well have been prevented with better intervention.

A second variety of the scam is the sale/leaseback that never quite works. This scenario includes various schemes under which homeowners surrender title to their houses in the belief that they are entering deals where they'll be able to remain as renters, and buy their homes back over the next few years. Homeowners are sometimes told that surrendering title is necessary so that someone with a better credit rating can secure new financing to prevent the loss of the home. But the terms of these deals are almost invariably so onerous that the buyback becomes impossible, the homeowner permanently loses possession, and the "rescuers" walk off with all or most of the home's equity. In some cases, the homeowner's mortgage is paid off, in others it is not – despite a due on sale clause – and the homeowner remains on the hook if the rescuer fails to make payments.

The third variety is a bait-and-switch where the homeowners ***do not realize*** they are surrendering ownership of their houses in exchange for a "rescue." Either the sale documents are forged or the homeowners are led to believe that they are only signing documents for a new loan to make the mortgage current. Many also say they had made it quite clear they had no intention of selling or giving up their home to anyone. Further evidence that homeowners have been gulled by this variant of the scam is the many cases in which the home is transferred for a ridiculously small fraction of its actual value.

Today, with homes much more likely to be upside down than to have equity worth stealing, equity stripping scams are less prevalent. "Phantom help," however, has taken off, under a new name: "loan modification specialists."

B. Loan Modification: The Hottest Business Since Subprime Lending

Prior to 2008 there was no "loan modification industry." Today, the loan modification industry is booming.

Advertising is all over TV, often late at night. It is on prime-time radio and the internet. It is in newspapers, on street flyers, signs and billboards, and on other direct mail solicitations.[17] A recent press release for JCR Advertising announces the national launch of an infomercial produced exclusively for loan modification companies.[18] The infomercial, entitled *Crisis on Main Street*, highlights news clips from Obama, Bush, Bernanke, McCain and others to provide "credibility to the campaign." Saturation marketing, which is often laced with lies and exaggerations,[19] and pressure tactics play on the desperation and trust of distressed homeowners. These are the same marketing practices that were used to sell the abusive loans that scammers now seek to modify.

Foreclosure rescue operators have seized on press reports about legitimate government and industry loan modification programs and publicity about millions of dollars of bailout money available. One website has bold red letters: "$75 Billion Released in Government Funds."[20] Homeowners who do not see any of that money trickling down to them, and who cannot get through to their servicers, are receptive to claims that an "expert" can help them cut through the red tape.

Many operations have adopted names that imply a government connection. One, "USHUD.com," has a byline: "The name you know, the name you trust."[21] The Federal Trade Commission has issued cease and desist orders to several with deceptive names or websites, including Federal Loan Modification and Bailout.hud.gov.us, and others that trade

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[17] *See* Alyssa Katz, Predatory Lending With a Smiley Face, salon.com (Mar. 3, 2004) available at http://www.salon.com/news/feature/2009/03/04/loan_modifications/.(describing loan mod company that "blitzes homeowners who have subprime loans and other high-risk mortgage with junk mail and telemarketing calls.

[18] *See* JCR Advertising Press Release, Crisis on Main Streets Delivers Big on over 200 Stations across the Country (Jan. 15, 2009), available at http://www.mortgagemag.com/news/2009/0101/1000010033070.htm.

[19] Often companies represent themselves as being affiliated with the federal or state governments. *See* John Leland, *Swindlers Find Growing Market in Foreclosures*, New York Times, p. A1 (Jan. 15, 2009).

[20] *See* http://www.ushud.com/loanmodification.html.

[21] *See* http://www.ushud.com/loanmodification.html.

on the legitimate Hope Now industry program, such as "Hope Assure," "Hope Now Modifications," "New Hope Property," and "New Hope Modifications."[22]

Most loan modification scams involve taking up front payments and doing little or nothing for the homeowner. However, other variations on this theme have also been reported.

- Charging a fee to obtain an *un*affordable loan modification;
- Charging exorbitant fees to homeowners attending loan modification seminars;[23]
- Charging thousands of dollars for "loan audits" which are not performed by an attorney or which are worthless because any potential claims the borrower may have are barred by a statute of limitations which has expired.

Regardless of the form they take, the bottom line is typically that the homeowner pays thousands of dollars and gets nothing in return. Here are a few examples.

• Queens, NY – The Middleton family with a young daughter battling cancer pays American Modification Agency $1990 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.[24]

• 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.[25]

• 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.[26]

• 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.[27]

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[22] *See* Press Release, "Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams," Federal Trade Commission (Apr. 6, 2009), http://www.ftc.gov/opa/2009/04/hud.shtm.

[23] Michale Doyle, *Claims to fix mortgages for fee set off red flags for the feds and Cardoza*, Modesto Bee (Oct. 25, 2008), available at http://www.modbee.com/local/story/475093.html (homeowners charged $3500 to attend workshop to resolve delinquent mortgage problems).

[24] Daniel Massey, *No Helping Hand*, Crain's New York Business (Jan. 10, 2009), available at http://www.crainsnewyork.com/article/20090111/FREE/301119975/rss22.

[25] John Leland, *Swindlers Find Growing Market in Foreclosures*, New York Times, p. A1 (Jan. 15, 2009).

[26] Renae Merle, *Firms Charge Thousands To Modify Mortgages: Nonprofits Offer Service For Free, Advocates Say*, Washington Post, p. A01 (Dec. 26, 2008).

[27] John Rebchook, Loan modification firms causing more problems for homeowners, Rocky Mountain News (December 24, 2008), available at

• 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 $3500 to the company their bank had not been contacted regarding a loan modification for the Mendez family.[28]

These stories represent just the tip of the iceberg. For too many families, loan modification scams make a precarious financial situation much worse. Homeowners are out thousands of dollars that could have been put towards their mortgages. Borrowers often fall further behind on their payments because loan modification companies frequently advise them to stop making mortgage payments. And, the foreclosure clock keeps ticking as borrowers wait for these companies to make good on their promises.

IV. DOES A "LEGITIMATE" FOR-PROFIT FORECLOSURE RESCUE INDUSTRY EXIST??

Many foreclosure rescue operations are run by scammers who have no intention of doing anything other than stealing the homeowner's money. But in designing a legislative response, policymakers confront the question whether legitimate foreclosure rescue operations exist. Certainly the need is real because of servicers' inadequate response to the foreclosure crisis. Though the free services offered by HUD-approved housing counseling agencies are unquestionably the first and best option for struggling homeowners, these counselors are overwhelmed and some homeowners report difficulties in getting through to them. For some homeowners, it would be well worth $2,000 or $3,000 to obtain an affordable modification of the loan that enables the family to save the home.

But whether the transaction began as a scam or merely is one that was unsuccessful, enormous damage is being inflicted on homeowners who pay thousands of dollars, lose valuable time and money, and get nothing. Thus, the real question is how far backwards lawmakers should bend to protect this industry. Our answer is: not very far.

A. Who Are These Loan Modification "Experts"? The Same Salesmen Who Got Us Into This Crisis.

Some have called the upstart industry the hottest business since subprime lending. Ironically, mortgage brokers and other real estate professionals, who saddled borrowers with unsustainable home loans, are now reaping more profit from the same borrowers by promising to fix their bad loans.[29]

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http://www.rockymountainnews.com/news/2008/dec/24/loan-modification-firms-causing-more-problems/.

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

[29] *See* Alyssa Katz, Predatory Lending With a Smiley Face, salon.com (Mar. 3, 2004) available at http://www.salon.com/news/feature/2009/03/04/loan_modifications/ (attached as Exhibit 1).

Indeed many loan modification companies 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.[30] Mortgage brokers—oft cited as one of the driving forces in the growth of bad subprime loans—are in demand.[31] For example, the Nationwide Foreclosure Prevention Center in Williamstown, NJ is looking for consultants with mortgage and real estate experience to join its cadre of loan modification specialists.[32] Its classified ad urges consultants to "Tap Into The Lucrative Loan Modification Industry" and suggests that consultants could earn up to $100k or more this year counseling troubled homeowners who are delinquent on their mortgage or facing foreclosure. The ad also 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).[33]

Another company advertising for loan modification consultants has taken out ads with pictures of obscenely expensive cars. One ad implies that the consultants will earn enough to buy a $200,000 Lamborghini.[34] Another ad features the $1 million plus Bugatti Veyron.[35]

These sales people work off of lists of homeowners who are 30, 60 or 90 days late on their mortgage, sold by lead generators who charge anywhere from a few cents to $20 or more per name, depending on whether the name is being sold exclusively to one firm or to several. The lead generators also emphasize that their leads are offered to sales people. One boasts, "This is the best file for direct mail, telemarketing, or voice broadcasting."[36]

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[30] Robert Berner, 'Help' Can Be Costly, BusinessWeek (Nov. 11, 2008).

[31] *See* Alyssa Katz, Predatory Lending with a smiley face, salon.com (Mar. 3, 2004) available at 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).

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

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

[34] *See* http://lasvegas.backpage.com/MiscJobs/work_from_home_loan_mod_sales_reps_needed_7_000_per_month_from_home_/classifieds/ViewAd?oid=1228365

[35] http://allcrs.newsreview.com/gyrobase/loan_modification_consultants_work_from_home_live_transfer_and_direct_response_leads_/classifieds/ViewAd?oid=1465704

[36] *See* http://www.globalmatrixleads.com/loan-modification-leads/.

The conclusion appears inevitable that these operations are set up primarily to profit from the distress of others (and to attract those whose motivation is greed), not to perform a real service. Why else would these companies need "strong closers" who are skilled at pressuring reluctant homeowners into buying the snake oil they are selling?

B. The Dangers of For-Profit Loan Modification Consultants Who Are Not Outright Scammers

Assume for the sake of argument that some of the companies advertising loan modification assistance are not simply out to take homeowners' money, but are engaged in actual attempts to modify the loans. Is this a business that policymakers should encourage?

The loan modification business has striking similarities to, and really is a variation of, the debt settlement industry. In fact, some loan modification firms *are* debt settlement companies. As Travis Plunkett of the Consumer Federation of America recently testified, the debt settlement industry's business model is inherently harmful to vulnerable consumers. The highlights of his testimony are equally applicable to for-profit loan modification consultants, who also:

- Often mislead consumers about the likelihood of reducing their debt/loan;
- Cannot guarantee that creditors will agree to a reduced payment if certain conditions are met;
- Often mislead consumers about the effect of the process on their credit worthiness;
- Charge such high fees that consumers have little chance of benefiting;
- Often will only work with the consumers in the most serious distress, who are the least likelihood to have a favorable outcome, and encourage consumers to put themselves in distress as a condition of helping them; and
- May do nothing until the firm's fees are paid in full.[37]

The most obvious problem is that homeowners in distress are paying a substantial amount of money, and losing valuable time waiting for help to arrive, without any guarantee that it will. At the end of the day, from the homeowner's perspective, there is no difference between a company that takes her money and runs off with it, and one that takes it, makes some futile attempts, and says, "sorry, we tried, but you can't have your money back."

Even assuming the most diligent efforts by the consultant, success against unresponsive servicers is likely to be just as elusive as it is for homeowners who try on their own. Less diligent consultants, who are more interested in earning that promised $200,000

[37] *See* Testimony of Travis B. Plunkett Before the Committee on Commerce, Science, and Transportation of the United States Senate Regarding Consumer Protection and the Credit Crisis at 8-10 (Feb. 26, 2009).

salary than wasting a lot of time on a hard case, are likely to give up and move on to the next case. Claims of a high success rates seem inherently suspect, yet may be hard to prosecute without delving into the firm's actual files.

It is also useful to put this discussion in the context of the loan modifications that servicers are actually offering. Even the lucky few who can get through to their servicer and actually get a loan modification are not out of the water. The latest numbers[38] for modifications made in March 2009 show that only 15% reduced the interest rate or the principal. Only 55% even reduced payments (most likely by stretching out the amortization schedule with a balloon payment at maturity). That is, 45% either *increased* payments or left the amount untouched. For the few who got write-offs of principal, the write-offs averaged 13%. (This contrasts with a loss rate of 64% for loans that went to foreclosure). And of the loan modifications made to date, about 50% have redefaulted.[39]

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 does not even guarantee any sort of loan modification. Moreover, the loan modifications obtained by for-profit firms are likely to be worse than the average. Unlike a nonprofit HUD-approved housing counseling agency, a for-profit loan modification consultant is likely to push the homeowner into taking the first modification offered, or to refuse to push for more, even if it offers little chance of actually saving the home.

Many loan modification firms give advice that can be damaging to homeowners, encouraging those who are not yet in default on their loans to become so. The advice may be direct, or the firm may tell homeowners that they cannot help them unless and until they are in default. Direct advice may be hard to prove without a "he said she said" and war of evidence. Indirect advice may not be actionable. As in the case of debt settlement companies, one has to wonder whether this posture is intended solely for negotiating purposes or whether the firm is also trying to free up resources to pay the firm's fees.

Finally, the substantial advertising spent to promote these firms obscures the message that homeowners are much better off taking advantage of the free, qualified help that is available from HUD-approved housing counseling agencies. One website, USHUD.com, even claims to be: "America's Only **Free** Foreclosure Resource." Some loan modification firms actively discourage homeowners from going to HUD-approved agencies, claiming superior expertise. Yet neither federal nor state laws impose *any* requirements on the substantive expertise that a for-profit loan modification firm must have to hold itself out

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[38] Prof. Alan White, "February and March Foreclosure Trends," Consumer Law and Policy Blog (Apr. 8, 2009), http://pubcit.typepad.com/clpblog/2009/04/february-and-march-foreclosure-trends.html.

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

as an "expert." As discussed above, the primary experience appears to be expertise at selling mortgage products.

By contrast, HUD-approved housing counseling agencies must be nonprofit, 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 acting in the best interest of the client, quarterly reporting to HUD of performance numbers, biennial site visits and review of client files, restrictions on charging fees, and record keeping requirements. The nonprofit 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. And all that for free.

HUD and the agencies it funds have made serious investments in the training of counselors. Allowing scammers to undermine their efforts is also working against federal investments.

C. What Else Are They Selling? Loan Mods That Turn Into Questionable Short Sales?

Information is beginning to surface about a new variety of foreclosure rescue involving the sale of a house that is upside down (that is, more is owed on the house than is worth). Indeed, some loan modification websites tout their expertise in short sales.

A true short sale is one where the lender agrees to take less than the full amount of the loan in order to clear title and permit the sale to proceed. As long as the lender is part of the process and everyone knows and agrees to the true sale price and the ramifications of a short sale, there is nothing unlawful about a short sale. Like a foreclosure, however, it has an impact on the homeowner's credit report. The lender may also insist that the homeowner remain liable for the deficiency, or even if it is forgiven, the homeowner may also owe taxes on the forgiven amount. The same is true if the lender were to permit the new buyer to assume the mortgage.

In one version of a short sale scam, the realtor and the buyer collude to conceal the full price of the sale from the lender so that they can pocket the difference, often by using option contracts and back to back closings. This version is aimed primarily at defrauding the lender, though the homeowner is also hurt by an artificially low sales price, either by being liable on a deficiency or by paying taxes on a higher forgiven balance. [40]

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[40] *See* Nick & Cindy Davis, "Sellers Beware of Short Sale Scams" (Apr. 21, 2009), http://www.city-data.com/blogs/blog5708-sellers-beware-short-sale-scams.html; Bill Gassett, "Short Sale Scammers We Buy Houses" (Aug. 14 2008); http://metrowestmarealestate.blogspot.com/2008/08/short-sale-

In another version of a short sale scam, the buyer takes over the mortgage without satisfying the due on sale clause and the sale is concealed from the lender.[41] The owner of a We Buy Houses franchise explained at trial that these deals work when the homeowner is only 10% to 15% upside down, because the home is sold to a buyer who is willing to pay a premium above fair market value to avoid a credit check because they cannot qualify for a regular loan.[42] Depending on how the transaction works, the homeowner may be out cash, lose the home, and still end up with a foreclosure on the credit report.

Even assuming that this scheme works for the buyer, whose name is not on the mortgage and whose credit is not at risk, the perils for the homeowner are great. The homeowner remains on the hook for the mortgage if the buyer defaults, risking both a foreclosure on the record and potential liability for any deficiency. Default by the new buyer may be likely, because the buyers that these deals attract are ones who want to avoid a credit check and a substantial down payment. That is, they are seeking the type of no doc/no money down loan of the type that led to the foreclosure crisis and is no longer available from regular lenders. The homeowner is also exposed to any other liability, civil or criminal, that comes with violating the due-on-sale clause and actively concealing that sale.

These transactions may begin as traditional loan modification contracts, in which the homeowner pays a fee in the hopes of saving the home. The rescuer may then pressure the homeowner into agreeing to the sale – and into paying a sales commission to the rescuer. Thus, the homeowner has to pay two fees, loses the home, may still have her credit blemished by a foreclosure if the new buyer defaults, and may be exposed to liability for violating the contract.

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scammers-we-buy-houses.html; "New "short sale" scam taking root?," St. Petersburg Times (April 22, 2008), http://blogs.tampabay.com/realestate/2008/04/new-short-sale.html.

[41] An article appearing on several real estate investing websites explains how the due on sale clause is avoided. "The game for us is how to transfer ownership to the property without getting caught by the lenderAttorney William Bronchick, "There's No "Due on Sale" Jail, http://www.legalwiz.com/due-on-sale-clause. That article – which pre-dates the foreclosure crisis and the loan modification explosion – explains a scheme in which the property is first transferred to an *inter vivos* trust in the name of the original homeowner, with that homeowner as a beneficiary. That transfer is exempt from the due-on-sale clause under federal law *as long as there is no change in occupancy*. But then, "Sammy Seller quietly assigns his interest under the trust to you [the buyer] (similar to a transfer of stock in a corporation). This assignment is not recorded in any public record. *Sammy moves out and you move in*" (emphasis added). The article – which is aimed at investors, not homeowners – addresses the risks that the parties could be held liable for fraud or other criminal liability, or for civil liability, argues that the risks are not great, and concludes that the transaction "is a risk versus reward gamble."

[42] Reporters Transcript, Adversary Proceeding at 35-46, *In re Michelle Perry,* No. 08-26905-C-7, *(Nunes v. Perry,* Adversary No. 08-2463), U.S. Bankruptcy Court (E.D. Cal. Feb. 11, 2009) (on file at National Consumer Law Center).

V. STATE FORECLOSURE RESCUE LAWS

A. State Foreclosure Consultant Laws

In the past five years, several states have enacted laws to deal with foreclosure rescue scams. About 24 states and the District of Columbia now have laws that impose constraints on foreclosure rescue operations, both those that merely involve a fee for service, and the sale/leaseback scams that involve transfer of title.[43]

Though not every state law contains every provision, the typical foreclosure consultant laws:

- Ban up front payments;
- Ban any compensation until the consultant has fully performed every promised service;
- Require the contract to detail exactly what the consultant is promising to do;
- Require the consultant to give the homeowner notice of the right to cancel the contract within 3 to 5 days – which is extended if the notice is not given or the contract otherwise violates the statute;
- Require other disclosures;
- Prohibit the consultant from obtaining a power of attorney;
- Some prohibit the consultant from taking an interest in the property;
- Prohibit the consultant from receiving compensation from a third party;
- Some require the contract to be in the language used to negotiate with the homeowner.

Most of these laws exempt nonprofits and a variety of licensed entities. The issues posed by these exemptions are discussed below.

Most state laws only address services to homeowners who are in foreclosure or are 30 to 90 days in default.

These laws have given enforcement agencies and homeowners useful tools. A number of states have used their foreclosure rescue laws against loan modification firms. More than 20 state law enforcers have taken actions against companies engaged in these types of deception, including 22 brought by Illinois Attorney General Madigan.[44] Though the scams

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[43] Arizona, California, Colorado, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Maryland, Minnesota, Missouri, Nebraska, Nevada, New Hampshire, New York, Oregon, Rhode Island, Washington and Wisconsin have specific foreclosure rescue laws. Massachusetts has enacted similar, but less detailed, provision in regulations under the states unfair and deceptive acts and practices statute. Michigan has a general credit repair statute imposing similar provisions that is broad enough to apply to foreclosure rescue operations.

[44] *See* Press Release, "Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams," Federal Trade Commission (Apr. 6, 2009), http://www.ftc.gov/opa/2009/04/hud.shtm.

have spread rapidly even in states that have strong laws, it is too early to say whether the scams will abate as publicity over enforcement efforts expands.

Reports of homeowners using these laws against loan modification scams are more scarce. Most likely, homeowners are unable to find attorneys to help in light of the relatively small dollar amounts involved, and the firms disappear once homeowners and state officials begin investigating them.

Of the substantive provisions, a clear ban on any fees *until the homeowner actually receives an acceptable loan modification* is the most important. In addition to using individuals or entities that fall within an exemption, there are some indications that companies are avoiding the advance fee bans by taking the money "in trust" until the "services" are performed. Of course, if the only service performed is to make calls without achieving a loan modification, the homeowner has no protection.

Most of these laws were passed, or are copied from laws that were passed, before the current wave of loan modification scams began. States have also been considering new approaches to deal with loan modification scams.

Illinois recently lowered its cap on the total fees for foreclosure consultant or loan modification services to 50% of the homeowner's monthly mortgage payment, unless the homeowner's mortgage payments are reduced for at least five years, in which case the cap goes up to the lesser of the value of any loan reduction for 12 months or one full monthly mortgage payment.[45] A fee cap tied to results is a useful way of enforcing a rule that the fee is earned only if an affordable loan modification actually results.

California permits real estate department licensees who wish to charge advance fees for loan modification services to submit their contracts for approval, and approved companies are listed on the department's website.[46] Unfortunately, licensing or approval requirements that do not have real teeth in them – requiring clear results for any fee – only end up giving the state's imprimatur to firms without effective oversight.

B. To What Extent Should Attorneys, Real Estate Brokers and Other Licensed Entities Be Exempt?

All state foreclosure consultant laws contain exemptions, typically for nonprofits[47] and certain licensed entities, including mortgage brokers, mortgage lenders, attorneys, real estate

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[45] 765 Ill. Comp. Stat. § 940/70 (effective Apr. 6, 2009).

[46] We have concerns about licensing or approval regimes that imply state blessing of these arrangements, though we do not have information about whether the companies listed on the California website have engaged in abusive conduct.

[47] The exemption for nonprofits has to date not proved problematic, but vigilance is needed to watch out for the creation of sham nonprofits as has occurred in the credit repair context to avoid the Credit Repair Organizations Act, 15 U.S.C. §§ 1679-1679j.

brokers, and depository institutions. The exemptions should extend only to conduct within the scope of the license, whether that is stated directly or implicitly in the statute.

These exemptions can be problematic, as many if not most of the difficulties involve individuals or firms that fall into these categories. Even if the exemption is limited to conduct within the scope of the license, the critical protection of banning advance fees will not apply unless the consultant violates some other law.

Moreover, some of the 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. States need to be careful in interpreting their licensing laws broadly to crack down on unlicensed operations, because in doing so they may open up a larger loophole in their foreclosure rescue statute for licensed entities.[48]

On the other hand, the definition of foreclosure consulting services covered by foreclosure rescue statutes is broad, and without an exemption it can reach to the work of honest and helpful real estate brokers, mortgage brokers and attorneys who can certainly play a role in helping a homeowner avoid foreclosure. Lawmakers need to be careful not to throw the baby out with the bathwater.

Massachusetts' foreclosure consultant regulation is the strictest in terms of coverage.[49] The only exemptions to the advance fee ban are for attorneys who prepare or file a bankruptcy petition or court proceedings to avoid a foreclosure, or loan application fees paid to a licensed mortgage broker or licensed mortgage lender. The regulation also requires that the attorney, broker or lender comply with all applicable laws and regulations.

This narrow exemption for mortgage application fees may be the best way to avoid an overbroad exemption for real estate or mortgage brokers. Both are normally paid only when a sale or mortgage is completed, and permitting an application fee allows their traditional activities to go forward. Maryland's law achieves a similar result by exempting mortgage and real estate brokers only when refinancing a mortgage or engaged in selling the property, respectively.[50] But if real estate or mortgage brokers go beyond their regular business of finding mortgages or selling homes and try to capitalize on the foreclosure crisis and loan modification efforts, they should be covered by the same rules as other foreclosure consultants.

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[48]For example, Pennsylvania was able to use its mortgage broker licensing requirements to crack down on out-of-state loan modification companies *See* Press Release, "Banking Department Takes Action Against Mortgage Modification Companies," Pennsylvania Department of Banking (Apr. 23, 2009). Though Pennsylvania does not presently have a specific foreclosure rescue statute, if it decides to adopt one it needs to be careful about the interplay with this broad interpretation of the mortgage broker statute.

[49] *See* 940 Code Mass. Reg. 25.02(b).

[50] *See* Md. Real Prop. § 7-302.

The role of attorneys is more complicated. Attorneys can play a wide number of roles in helping a client avoid foreclosure – from filing a bankruptcy petition, a suit challenging a predatory loan, or a defense to foreclosure, to activities that do not involve litigation, including advising a client on potential claims or defenses or on the intricacies of loan modification programs, or negotiating a settlement with a lender for a client outside of litigation. Though some attorneys have unquestionably been involved in harmful conduct, an attorney's traditional role of analyzing a client's paperwork and advising the client of potential claims and options fits within the definition of foreclosure consulting services. These services take time, cannot always be offered for free, and cannot guarantee a successful claim. Even my office, which is a nonprofit, charges other attorneys for consulting services that can include loan documentation analysis. Thus, drawing a clear line that excludes harmful conduct but does not prevent beneficial advice and activities is not so easy.

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

On the other hand, it may be possible to attack those who use the guise of an attorney license to cloak activities by nonlawyers and to fit within the attorney exemption in statutes that ban advance fee bans. For example, some loan modification firms that are owned by real estate or mortgage professionals tout the attorney services that they offer. Conversely, some attorneys are running large loan modification operations or other large operations staffed largely by nonlawyers doing nonlegal work. Lawmakers should consider ways to narrow any exemption for attorneys to exclude these types of activities.

State bars should also do a better job of cracking down on abusive advertising practices by attorneys. That is, it might be appropriate for a state bar to adopt a rule that, if an attorney does not want to abide by a foreclosure consultant law that prohibits advance fees until and unless a loan modification is obtained or a foreclosure avoided, then the attorney must refrain from advertising services that hold out the promise of those results.

C. State Laws Governing Sale/Leaseback Transactions

Most of the state foreclosure rescue laws also govern transactions in which title to the home is actually transferred but the homeowner retains possession. Though these transactions are less prevalent today as fewer and fewer homeowners have equity to steal, they have not disappeared.

Sale/leaseback scams are typically addressed through laws governing "foreclosure purchasers" who take title to a home with the homeowner remaining in possession. As with foreclosure consultant provisions, most foreclosure purchaser laws do not ban the

transactions but impose extensive requirements and notice of a three- or five-day right to cancel, with the time extended if the contract does not comply.

The typical foreclosure purchaser statute prohibits an array of deceptive, unfair, and abusive practices. Many prohibit unconscionable contract terms. Some prohibit deception in broad terms. Another common provision is a cap on fees or interest rates for any loans, or a requirement that a rescuer who purchases the property must pay at least a certain percentage of its fair market value, typically 82%. Some statutes prohibit the rescuer from entering into an agreement to reconvey the home to the homeowner unless the homeowner has a reasonable ability to meet the requirements for reconveyance.

Massachusetts, Maryland and the District of Columbia take a stronger approach to sale/leaseback transactions: they ban them. Massachusetts and DC directly prohibit transactions, entered into for profit or gain, intended to delay or forestall foreclosure in which the property is conveyed but the homeowner retains possession.[51] Maryland achieves the same result indirectly in its foreclosure consultant law by prohibiting the consultant from taking an interest in the property.[52]

These state laws have been effective in cutting back on the number of sale/leaseback scams, though the full effect of the newer laws is not yet clear as these scams can take a year or two to ripen and come to the attention of homeowner attorneys and enforcement officials. The statutes that have been invoked in litigation have done well in giving consumers who are victimized effective remedies against the scammer. The homeowner may still have difficulty gaining complete relief, however, if the straw buyer has taken out a new mortgage or has sold the property to an innocent third party.

The National Consumer Law Center has developed a model state foreclosure rescue scam law that treats sale/leaseback transactions as what they really are: a loan, rather than a sale.[53] Using the century-old common law equitable mortgage doctrine,[54] the law converts the sale into a loan and requires the rescuer to comply with lending laws. The model law also sets out a detailed remedy scheme that none of the state laws includes, and sets out factors to consider when a mortgage lender or purchaser claims to be an innocent third party but in fact had enough notice to know better.

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[51] 940 Code of Mass. Reg. 25.00 *et seq.*; DC Stat. § 42-2432.

[52] *See* Md. Code Real Prop. § 7-307.

[53] The model law is available on our website at http://www.nclc.org/issues/foreclosure/index.shtml and is attached as Exhibit 2.

[54] *See, e.g.,* Russell v. Southard, 53 U.S. 139 (1851); Lynch v. Murphy, 161 U.S. 247 (1896); *In re* Cox, 493 F.3d 1336 (11th Cir. 2007) (Georgia law); National Consumer Law Center, Foreclosures §15.4 (2d Ed. 2007 & Supp. 2008).

VI. THE ROLE OF FEDERAL LEGISLATION

A. General Principles

As the presence of state legislation and the current activity of state legislators on this subject demonstrates, state law is not preempted in the area of foreclosure rescue scams, and states who choose to do so face no significant obstacles in passing laws to govern these operations. States are also in position to address the interplay with state licensing regimes for attorneys, mortgage brokers, and others who have legitimate reason to be exempted but can also be part of the problem.

Nonetheless, federal legislation can be helpful as long as it:

- creates strong, significant protections and not just disclosure hoops for scammers to jump through;
- is enforceable by the homeowners who are victimized and creates significant penalties for the scammers;
- is a floor and not a ceiling and does not preempt stronger state laws;
- helps in developing a clear national message about the dangers of these schemes;
- does not excessively restrict legitimate services outside the scope of the statute; and
- does not end up inadvertently legitimizing a very problematic industry.

We do not recommend new federal legislation to address sale/leaseback scams in which the homeowner's title is actually transferred. These scams, which target equity, are less prevalent in today's declining market. The federal Truth In Lending Act has been effectively used in combination with state equitable mortgage doctrines to invoke TILA's rescission remedies. Specific state legislation has also been effective in giving homeowners remedies. Anything short of a complete, strong, flat out federal ban on sale/leaseback transactions could risk undermining these successful strategies and legitimizing a model that provides no benefits to homeowners.

B. H.R. 1231, the Foreclosure Rescue Fraud Act of 2009

Representatives Gwen Moore and Barney Frank have introduced H.R. 1231, the Foreclosure Rescue Fraud Act of 2009, the companion bill to Senator Herb Kohl's S. 117. H.R. 1231 is a similar, somewhat simplified version of the state legislation discussed above in effect in about 23 states and the District of Columbia. A modified version of the bill was recently offered, and then withdrawn, as an amendment to H.R. 1728.

By banning advance fees for foreclosure consultants, the bill addresses the most problematic aspect of this industry: taking money for doing or achieving nothing.[55] It

[55] The bill appropriately does not address sale/leaseback scams, which are better left to states, other than by prohibiting a consultant from taking an interest in the property or a power of attorney from the homeowner.

makes possible a clear, nationwide message against advance fees. The bill also has a clear provision protecting stronger state laws and is enforceable by the victimized homeowner.

The bill could be strengthened, however, as could state legislation on this subject:

- Homeowners should have more time, 30 days, to cancel the contract;
- The advance fee prohibition should not be circumvented by taking money in trust or escrow (unless of course in connection with an exempt transaction such as an attorney's retainer agreement);
- The bill should be clear that the fee is not earned unless and until the consultant delivers actual results. Merely performing services that lead nowhere is not enough;
- The results must include a long-term, affordable loan modification or another outcome that has a substantial probability of saving the home. A loan modification that increases payments, keeps unaffordable payments the same, or otherwise is likely to lead to redefault should not qualify;
- Any fee cap should be commensurate with the results obtained;
- The penalties for violations should be the greater of *triple* the consultant's fee or the amount of actual damages. Merely requiring a refund of the fee is not a significant deterrent.

The latest version of the bill omits any exemption for real estate brokers, which will help to avoid evasion of the bill's protections.

The latest version also includes attorneys, though it permits advance fees for preparing or filing bankruptcy petitions or court proceedings to avoid a foreclosure. As discussed above, this exemption is too narrow and could prohibit legitimate activities by attorneys, but there may be ways to carve out legitimate attorney services while including nonlawyer services that seek to exploit an attorney exemption.

With these improvements, H.R. 1231 can be useful in protecting homeowners nationwide from loan modification firms that take their money without providing an affordable loan modification.

VII. CONCLUSION

Poor servicing has pushed many borrowers to seek assistance from loan modification companies, but the loan modification industry is complicit in fleecing financially distressed homeowners. Many times these companies take up front fees based on promises of loan modifications that never materialize. While many states have taken steps to curb these practices, existing laws could be tightened up.

Congress can help first and foremost by addressing the servicing problems and providing more resources for HUD-approved housing counseling agencies and enforcement.

Congress could also adopt strong, minimum, national standards to assist the majority of states that does not have foreclosure rescue laws.

Statement of Robert E. Story, Jr., CMB

Before the House Financial Services Subcommittee on Housing and Community Opportunity

Hearing on "Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud"

May 6, 2009

Chairwoman Waters, Ranking Member Capito, thank you for inviting the Mortgage Bankers Association (MBA)[1] to discuss the very important issue of foreclosure rescue scams. My name is Robert E. Story, Jr., CMB, and I am Chairman-Elect of the Mortgage Bankers Association (MBA). I am also President and Chief Executive Officer of the Seattle Financial Group.

I am here today because MBA shares the concerns of this subcommittee about the rise of foreclosure rescue scams and the need to protect innocent homeowners from unscrupulous individuals. The impact of such outright fraud, scams and deceptive practices results in borrowers being scammed out of thousands of dollars or worse, their homes. Moreover, these scams severely undermine legitimate foreclosure prevent efforts.

Those who commit financial fraud prey on people who are at the end of their financial rope. In the midst of a recession, with borrowers facing greater financial hardships, delinquency and foreclosure rates are rising. Fraudsters are targeting these troubled borrowers. Borrowers need to turn to the right sources for help. However, in many cases, borrowers in trouble are often reluctant to call their mortgage servicers or other trustworthy companies. In other cases, borrowers actively look for help. In both these cases, borrowers may come in contact with individuals or businesses that are looking to scam them.

MBA and our foreclosure prevention coalition partners, such as HOPE NOW[2], have worked hard to make borrowers more aware of free and legitimate homeownership counseling. These efforts include homeowner education and outreach on an unprecedented scale. HOPE NOW and its partners, NeighborWorks and the Homeownership Preservation Foundation, continue to support the HOPE hotline to help borrowers navigate loss mitigation and other financial solutions. The HOPE hotline is free and its home retention counselors

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] MBA is a partner in the HOPE NOW alliance, a partnership among counselors, mortgage market participants, and mortgage servicers to create a unified, coordinated plan to reach and help as many homeowners as possible. Since its inception in 2007, HOPE NOW has expand its outreach efforts to include public service announcements that encourage delinquent borrowers to contact the person to which they send their mortgage payment, or a qualified housing counselor at 1-888-995-HOPE.

are approved by the U.S. Department of Housing and Urban Development (HUD).

Mortgage Fraud

The increasing unemployment rate and continued delinquency rate of homeowners provides scammers and criminals with the opportunity to exploit vulnerable homeowners seeking financial guidance. Such scams can take many forms, but two of the most common are:

- **Phantom Help** – In these cases, for-profit counselors promise to complete paperwork and obtain a loan workout settlement in exchange for up to thousands of dollars. The scammers either do not follow through or perform menial tasks that the borrower could complete easily and for free. At best, these for-profit companies perform the same services HUD-approved counselors and servicers do for free.

- **Title Transfers** – Perpetrators convince homeowners that they can save their homes from foreclosure through deed transfers and promises to lease back or sell back the property. This type of so-called "foreclosure rescue" often is a manipulated deed process that results in the preparation of forged deeds or fraudulent lien releases. In extreme instances, perpetrators sell the home or secure a second loan without the homeowners' knowledge, stripping the property's equity for personal gain.

Many mortgage rescue scams start with a phone call, mailing Web site or advertisement promising help. Most of these advertisements are virtually indistinguishable from legitimate organizations offering assistance and often use names identical or similar to legitimate organizations. They are designed to achieve one thing only: to lure a person who is desperate for help.

Once a fraudster makes contact with a distressed borrower, the borrower is inevitably told that their situation is dire and that they are going to lose their house. The scammer does everything he or she can to raise the anxiety level of the borrower. Just when the borrower is at his or her lowest point, the person on the other end of the phone says there may be some hope, but only if the borrower agrees to cooperate. Next, the borrower will be told to cease any communication with their lender to avoid being detected.

At this point, the borrower is convinced the person offering his or her services is the only solution and agrees to pay money for services or signs documents including transfers of title to the property. The psychological pressure imposed on the borrower is intense and fraudsters know how to instill a strong sense of desperation.

Contact Your Servicer First

MBA encourages borrowers in financial trouble to call their mortgage servicer right away. Mortgage servicers have an economic incentive to avoid foreclosure and are the entity with legal authority to make repayment plans, or refinance or modify a mortgage. Borrowers can also contact trustworthy sources for advice and counseling such as the HOPE hotline at 1-888-995-HOPE or a HUD-approved counselor (a list is available on HUD's Web site). State and local governments across the country have also set up hotlines, as have churches, legal aid societies and consumer assistance organizations.

MBA and Law Enforcement Respond to Escalating Mortgage Fraud

Fighting mortgage fraud is a top priority for MBA. Fraud not only affects the borrower but impacts mortgage companies to the tune of hundreds of millions of dollars every year.

While no authoritative statistics are available on the full extent or the cost of foreclosure rescue scams, MBA's members continue to report an increasing number of overall mortgage fraud cases. According to the Mortgage Asset Research Institute (MARI), incident reports of mortgage fraud increased 26 percent from 2007 to 2008.[3] While the vast majority of such fraud occurs at the origination of a loan, some of this fraud is specific to mortgage rescue scams or debt elimination scams.

MBA believes the first way to stop this fraud is by raising awareness of these scams. The Department of the Treasury and the federal banking regulators has issued alerts for consumers on foreclosure rescue scams. The FTC has produced a fact sheet for consumers warning them about services that promise to stop the foreclosure process regardless of the borrower's circumstances, accept payment only in the form of a cashier's check or wire transfer or offers to fill out paperwork for the borrower.[4]

MBA believes that new laws are not needed to investigate and prosecute mortgage fraud. While some fraud prevention and enforcement proposals have focused on amending federal law, current federal law empowers law enforcement officials with sufficient authority and tools to combat mortgage fraud. The federal mail and wire fraud statutes, which are broadly phrased and have been broadly interpreted, reach all possible varieties of mortgage fraud. Additional federal statutes apply to certain instances of mortgage fraud committed against federally

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[3] James, Denise, Butts, Jennifer, Donahue, Michelle, "Eleventh Periodic Mortgage Fraud Case Report," Mortgage Asset Research Institute, March 2009: <http://www.marisolutions.com/pdfs/mba/mortgage-fraud-report-11th.pdf>

[4] See "Foreclosure Rescue Scams; Another Potential Stress for Homeowners in Distress," Federal Trade Commission: <http://wwwftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm>

regulated or insured institutions, providing federal law enforcement officials with additional avenues to combat mortgage fraud. Unlike new legislation, which always carries with it the risk of unexpected interpretations, existing law is tested by years of judicial precedent and can be applied by federal law enforcement officers with confidence.

Rather than enacting new legislation MBA believes a more effective approach is to educate borrowers on how to identify and avoid foreclosure rescue scams. Another way to reduce mortgage fraud is to increase the level of resources needed by law enforcement officials to combat mortgage fraud. This can be accomplished by: 1) providing more funding for mortgage fraud prevention and prosecution efforts; 2) assuring that investigative and prosecutorial resources are committed to mortgage fraud prevention, including foreclosure rescue scams; 3) placing responsibility for law enforcement of all mortgage fraud in a dedicated office within the Department of Justice; and 4) encouraging further intergovernmental cooperation in prosecuting mortgage fraud, as was exhibited in Treasury Secretary Timothy Geithner's announcement to crackdown on foreclosure rescue scams through coordination of the federal banking regulators' law enforcement offices by the Financial Crimes Enforcement Network (FinCEN).

In the past, MBA has asked Congress to appropriate $6.25 million per year over five years to provide dedicated funding for the Federal Bureau of Investigation (FBI) to investigate and prosecute mortgage fraud. The funding would provide for new FBI field investigators; additional prosecutors dedicated to mortgage fraud; and support for the operations of FBI Interagency Task Forces in the areas with the 15 highest concentrations of mortgage fraud. Greater funding may be needed in fiscal year 2010 to address the proliferation of these new schemes.

Borrower Tips For Avoiding Foreclosure Rescue Scams

As discussed above, fraudsters mislead homeowners into believing they can help them avoid foreclosure in exchange for a transfer of the deed, usually in the form of a quit-claim deed. The crooks then usually seek out a fraudulent lien release and quickly re-mortgage the property or sell it. The victim loses the property and any fees they may have paid. Because the lender is not paid off as promised, the borrower remains responsible for the mortgage debt as well. To protect borrowers from becoming a victim of a foreclosure rescue scheme, MBA cautions consumers to keep these points in mind:

- If it sounds too good to be true, it probably is.
- Beware of offers to "save" homeowners from default or foreclosure. Such scams often come in the form of unsolicited contacts and use high-pressure sales techniques.

- The moment you realize you may have troubles paying your mortgage, contact your mortgage company. The sooner, the better. The longer you wait, the fewer options you will have.

- If you are unwilling or unable to contact your mortgage company, seek a qualified credit counselor or an attorney to assist you.

- Open all your mail from your mortgage servicer. Servicers send multiple notices to assist delinquent borrowers. Borrowers who are 45 days delinquent will receive information on how to contact a HUD-approved counselor. Moreover, every borrower is eligible to call (888) 995-HOPE, a toll free counseling service that is free to borrowers.

- Do not sign a document you have not read or do not understand, especially under duress.

- Make sure that your servicer is fully aware of and approves any transfer of title (deed) to your property. Failure to do so could make the mortgage immediately due and payable in full. Moreover, you will remain liable for any debt that was not paid off upon sale or transfer of the property.

Conclusion

On behalf of MBA, I would like to thank the subcommittee for the opportunity to present our views on protecting homeowners from falling victim to fraudulent schemes. Mortgage fraud is a growing problem that is becoming more expensive for homeowners and lenders. MBA believes that increased enforcement, better communication, and further innovation is required in order to adequately protect borrowers and the industry, taxpayers and communities, from the costs of mortgage fraud.

PREPARED STATEMENT OF

THE FEDERAL TRADE COMMISSION

on

"Foreclosure Rescue and Loan Modification Scams"

Before the

HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
UNITED STATES HOUSE OF REPRESENTATIVES

Washington, D.C.
May 6, 2009

I. Introduction

Chairwoman Waters, Ranking Member Capito, and members of the Subcommittee, I am Peggy Twohig, Associate Director of the Division of Financial Practices at the Federal Trade Commission (FTC or Commission).[1] I appreciate the opportunity to appear before you today to discuss the Commission's efforts to protect consumers from foreclosure rescue and loan modification scams.

With the rapid increase in mortgage delinquencies and foreclosures, the FTC has intensified its efforts to protect consumers from foreclosure rescue and loan modification scams and to halt the proliferation of these types of scams. In a little over a year, the Commission has brought eleven cases targeting mortgage foreclosure rescue and loan modification scams. Most recently, on April 6, 2009, the FTC – along with other federal and state regulators – announced law enforcement actions and consumer education initiatives as part of a broader crackdown on loan modification and foreclosure rescue entities. In addition, the Commission announced a new consumer outreach and education initiative to reach borrowers directly with the help of a broad array of government, non-profit organizations, and mortgage industry members. Through this initiative, borrowers will receive materials about how to spot and avoid mortgage rescue scams directly from their mortgage companies, at housing counseling outreach centers, and online. These efforts are part of a larger focus on financial services: for example, the Commission has brought more than 70 enforcement actions in the past five years and provided $465 million in redress to American consumers in financial services cases in the last ten years.

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[1] The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions are my own, however, and do not necessarily reflect the views of the Commission or any particular Commissioner.

The FTC also will be considering what rules are warranted to more comprehensively protect consumers in this marketplace. The Omnibus Appropriations Act of 2009 authorized the FTC to issue rules to prohibit unfair or deceptive practices with respect to mortgage loans. The Commission anticipates that this rulemaking authority will be helpful in addressing mortgage loan modification and foreclosure rescue services.

This testimony provides an overview of the FTC's consumer protection authority and describes the Commission's recent law enforcement, consumer education, and policy development efforts to protect financially distressed homeowners from mortgage relief scams.

II. Overview of FTC Authority

The Commission has law enforcement authority over a wide range of acts and practices throughout the consumer credit life-cycle. The agency enforces Section 5 of the Federal Trade Commission Act, which prohibits "unfair" or "deceptive" acts or practices in or affecting commerce.[2] The Commission also enforces other consumer protection statutes that govern financial services providers. These include the Truth in Lending Act,[3] the Home Ownership and Equity Protection Act,[4] the Consumer Leasing Act,[5] the Fair Debt Collection Practices Act,[6] the

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[2] 15 U.S.C. 45(a)(1).

[3] 15 U.S.C. 1601-1666j (mandates disclosures and other requirements in connection with consumer credit transactions).

[4] 15 U.S.C. 1639 (provides additional protections for consumers entering into certain high-cost mortgage refinance loans).

[5] 15 U.S.C. 1667-1667f (requires disclosures, limits balloon payments, and regulates advertising in connection with consumer lease transactions).

[6] 15 U.S.C. 1692-1692p (prohibits abusive, deceptive, and unfair debt collection practices by third-party debt collectors).

Fair Credit Reporting Act (FCRA),[7] the Equal Credit Opportunity Act,[8] the Credit Repair Organizations Act,[9] the Electronic Funds Transfer Act,[10] the Telemarketing and Consumer Fraud and Abuse Prevention Act,[11] and the privacy provisions of the Gramm-Leach-Bliley Act.[12]

Although the Commission has authority over a wide range of acts and practices related to financial products and services, many financial service providers are exempt from the Commission's jurisdiction under the FTC Act.[13] Banks, thrifts, and federal credit unions are exempt from the Commission's jurisdiction. The Commission's jurisdiction under the FTC Act reaches only to non-bank financial companies, including non-bank mortgage companies, mortgage brokers, and finance companies. In addition, the Commission does not have

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[7] 15 U.S.C. 1681-1681x (imposes standards for consumer reporting agencies and information furnishers; places restrictions on the use of consumer report information). The Fair and Accurate Credit Transactions Act of 2003 amended the FCRA. Pub. L. No. 108-159, 117 Stat. 1952 (2003).

[8] 15 U.S.C. 1691-1691f (prohibits creditor practices that discriminate on the basis of race, religion, national origin, sex, marital status, age, receipt of public assistance, and the exercise of certain legal rights).

[9] 15 U.S.C. 1679-1679j (mandates disclosures and other requirements in connection with credit repair organizations, including a prohibition against charging fees until services are completed).

[10] 15 U.S.C. 1693-1693r (establishes the rights and responsibilities of institutions and consumers in connection with electronic fund transfer services).

[11] 15 U.S.C. 6101-6108 (provides consumer protection from telemarketing deception and abuse and requires the Commission to promulgate implementing rules).

[12] 15 U.S.C. 6801-6809 (requires financial institutions to provide annual privacy notices; provides consumers the means to opt out from having certain information shared with non-affiliated third parties; and safeguards customers' personally identifiable information).

[13] *See* 15 U.S.C. 45(a)(2).

jurisdiction under the FTC Act over non-profit organizations.[14]

III. FTC's Protection of Consumers from Foreclosure Rescue and Loan Modification Scams

In this current economic crisis, homeowners in financial distress are particularly vulnerable to unfair, deceptive, and otherwise unlawful business practices. The rate of mortgage loan delinquency and foreclosure has risen to the highest level in three decades.[15] With the rapid increase in mortgage delinquencies and foreclosures, the Commission has intensified its efforts to protect consumers in the financial services marketplace from foreclosure rescue and loan modification scams. As detailed below, the FTC is employing all of its tools – law enforcement, consumer outreach and education, and policy development – to halt the proliferation of mortgage relief scams.

A. FTC Law Enforcement

With the rapid increase in mortgage delinquencies and foreclosures, the FTC has stepped up its efforts to protect consumers from foreclosure rescue and mortgage loan modification

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[14] *See* 15 U.S.C. 44. The FTC does, however, have jurisdiction over for-profit entities that provide mortgage-related services as a result of a contractual relationship with a non-profit organization. *See Nat'l Fed'n of the Blind v. FTC*, 420 F.3d 331, 334-35 (4th Cir. 2005). In addition, the Commission asserts jurisdiction over "sham charities" that operate as for-profit entities in practice.

[15] *See* Mortgage Bankers Association (MBA), *Delinquencies Continue to Climb in Latest MBA National Delinquency Survey* (Mar. 5, 2009), *available at* http://www.mbaa.org/NewsandMedia/PressCenter/68008.htm. According to the MBA's National Delinquency Survey, the delinquency rate for mortgage loans on one-to-four unit residential properties rose to a seasonally adjusted rate of 7.88% of all loans, as of the end of the fourth quarter of 2008, which is the highest rate ever based on data dating back to 1972. Over 11% of loans are either in foreclosure or delinquent by at least one payment, which is the highest rate ever recorded in the MBA national delinquency survey.

scams. In a little over a year, the FTC has brought eleven cases targeting mortgage foreclosure rescue and loan modification scams[16] and is actively engaged in ongoing, non-public investigations. On April 6, 2009, the FTC – along with Treasury Secretary Geithner, Attorney General Holder, HUD Secretary Donovan, and Illinois Attorney General Madigan – announced law enforcement actions and consumer education initiatives as part of a broader crackdown on loan modification and foreclosure rescue entities.[17] In connection with this effort, the Commission also sent warning letters to 71 companies for marketing potentially deceptive mortgage loan modification and foreclosure assistance programs.[18]

The FTC's law enforcement actions regarding foreclosure rescue and loan modification schemes typically allege the following:

First, the defendants use terms like "guarantee" and "97% success rate" to mislead

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[16] *FTC v. Federal Loan Modification Law Center, LLP*, Case No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009); *FTC v. Thomas Ryan*, Civil No. 1:09-00535 (HHK) (D.D.C. filed March 25, 2009); *FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009); *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. Mar. 17, 2009); *FTC v. National Foreclosure Relief, Inc.*, No. SACV09-117 (C.D. Cal. Feb. 2, 2009); *FTC v. United Home Savers, LLP*, No. 8:08-cv-01735-VMC-TBM (M.D. Fla. Sept. 3, 2008); *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075 (N.D. Ohio April 28, 2008); *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv-388-T-23EAJ (M.D. Fla. Feb. 26, 2008); *FTC v. National Hometeam Solutions, Inc.*, No. 4:08-cv-067 (E.D. Tex. Feb. 26, 2008); *FTC v. Safe Harbour Foundation*, No. 08 C 1185 (N.D. Ill. Feb. 25, 2008).

[17] *See* Press Release, *Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams* (Apr. 6, 2009), *available at* http://www.ftc.gov/opa/2009/04/hud.shtm; Press Release, *Federal, State Partners Announce Multi-Agency Crackdown Targeting Foreclosure Rescue Scams, Loan Modification Fraud* (Apr. 6, 2009), *available at* http://www.ftc.gov/opa/2009/04/loanfraud.shtm.

[18] An example of these letters is available at http://www.ftc.gov/os/2009/04/090406warningletter.pdf.

consumers about the foreclosure rescue and loan modification services they provide.[19] Sometimes, the defendants will also promise a full refund in the event that negotiation efforts to obtain a loan modification or to prevent foreclosure are unsuccessful. Second, they charge up-front fees for these "services." Lastly, after collecting the fee, the defendants do little or nothing to help consumers obtain a loan modification or stop foreclosure. For example, in one case the Commission charged a foreclosure rescue operation for promising consumers that it could stop "any foreclosure," but then failing to stop foreclosure or taking even minimal steps to do so.[20] Consumers are unlikely to receive a refund or recover the money they paid up-front as a fee, which is as high as thousands of dollars. Such operations not only defraud financially distressed consumers out of desperately needed funds but also may lead them to forgo viable options for avoiding foreclosure, such as getting assistance from a non-profit housing counselor.[21]

Sometimes the defendants use copycat names or look-alike websites to appear to be affiliated with a non-profit or government entity, when in fact they are not.[22] The defendants

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[19] Additionally, some entities claim to be associated with or to have good relationships with the consumer's mortgage servicer. *See FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009).

[20] *See FTC v. National Hometeam Solutions, LLC*, Case No. 4:08-cv-067 (E.D. Tex. filed Feb. 26, 2008). *See also FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009) (alleging that defendant promised "100% SATISFACTION GUARANTEE OR YOUR MONEY BACK").

[21] In addition, some FTC defendants advise consumers, including those who are still current on their loans, to stop making mortgage payments and to cease communication with their mortgage servicer while the operator purportedly negotiates on their behalf. *See, e.g., FTC v. Home Assure, LLC*, Case No. 8:09-CV-00547-T-23T-SM (M.D. Fla. filed Mar. 24, 2009); *FTC v. National Hometeam Solutions, LLC*, Case No. 4:08-cv-067 (E.D. Tex. filed Feb. 26, 2008).

[22] For example, the Commission alleged that a defendant marketing purported loan modification services represented, via his website, that he was the "House and Urban Department" by displaying a government-like seal and using a web address ("bailout-hud-

may also make express or implied misrepresentations that Members of Congress or other government officials endorse their services or products. In one case, against Federal Loan Modification Law Center LLP, the FTC alleged that the defendants misrepresented that they were part of or affiliated with the federal government and that they could obtain a loan modification in all or virtually all instances.[23] On April 24, 2009, the court in that matter issued a preliminary injunction prohibiting the company from making claims about its likelihood of obtaining or negotiating home loan modifications for consumers, collecting up-front fees, and claiming any affiliation with the United States government.

In two other recent cases, the Commission alleged that the defendants misrepresented that they were part of the legitimate Hope Now Alliance of housing counselors and mortgage servicers – using similar sounding names and representing to consumers that they were part of the Alliance. In addition, the defendants misrepresented to delinquent borrowers that they would obtain mortgage loan modifications and prevent foreclosure and that, if unsuccessful, they would provide refunds to consumers.[24] In both cases, the court issued temporary restraining orders enjoining the deceptive practices and imposing an asset freeze. Last week, the court entered stipulated preliminary injunction orders continuing the core conduct prohibitions and asset freeze

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gov.us" or "bailout.dohgov.us") and other features to create the impression that his business was associated with the U.S. government. *FTC v. Thomas Ryan*, Civil No. 1:09-00535 (HHK) (D.D.C. filed Mar. 25, 2009).

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

[24] *FTC v. Hope Now Modifications*, No. 1:09-cv-01204-JBS-JS (D.N.J. filed Mar. 17, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. filed Mar. 17, 2009).

provisions.

B. Consumer Outreach and Education

In tandem with its law enforcement actions, the Commission has initiated a stepped-up consumer outreach and education initiative on foreclosure rescue and loan modification fraud. The FTC has warned consumers about these mortgage-relief scams that charge hefty fees for their services – the same services that consumers can undertake by contacting their mortgage servicer directly or obtain for free through non-profit organizations like the Hope Now Alliance.[25]

Most recently, the FTC announced a new education initiative to reach borrowers directly with the help of a broad array of government, non-profit organizations, and mortgage industry members. Through this initiative, borrowers will receive materials about how to spot and avoid mortgage rescue scams directly from their mortgage companies, at housing counseling outreach centers, and online. Joining the FTC in the effort are the Hope Now Alliance, the Homeowners Preservation Foundation, and NeighborWorks America, which are non-profit organizations that work to help distressed homeowners get free help and counseling through HUD-certified housing counselors, all of whom work directly with borrowers to help them stay in their homes. Several national mortgage companies, including Chase Home Lending, Suntrust Mortgage, and GMAC Mortgage, will be voluntarily sending FTC consumer education information directly to consumers through a variety of methods, including during loan counseling sessions, in monthly statements, in correspondence to delinquent borrowers, and on their Web sites. Freddie Mac

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[25] *See, e.g.*, FTC Publication, *Foreclosure Rescue Scams: Another Potential Stress for Homeowners in Distress*, *available at* http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm.

also is distributing consumer education materials to its servicing partners.[26] This week, the Commission provided mortgage servicers and others with audio public service announcements (PSAs) from the FTC warning consumers about mortgage foreclosure scams and giving them tips on how to avoid them. The FTC has encouraged servicers to play these PSAs while borrowers are on hold with servicers' customer service and loss mitigation departments as part of our efforts to reach out directly to borrowers.

C. Mortgage Loan Rulemaking

Pursuant to the Omnibus Appropriations Act of 2009, the FTC has new rulemaking authority to prohibit unfair or deceptive practices with respect to mortgage loans. The Omnibus Appropriations Act of 2009 enacted on March 11, 2009 directed the Commission to commence within ninety days a rulemaking proceeding with respect to mortgage loans.[27] This new legislation allows the FTC to use the relatively streamlined notice and comment rulemaking procedures under Section 553 of the Administrative Procedure Act (APA) in promulgating these rules, rather than Magnuson-Moss procedures.[28] As part of this rulemaking proceeding, the

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[26] *See* Press Release, *Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams* (Apr. 6, 2009), *available at* http://www.ftc.gov/opa/2009/04/hud.shtm; FTC Publication, *A Note to Homeowners*, *available at* http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea16.pdf.

[27] Omnibus Appropriations Act 2009, Pub. L. No. 111-8, § 626, __ Stat. __ (Mar. 11, 2009).

[28] 5 U.S.C. 553. Section 626 of the Omnibus Appropriations Act authorizes use of these procedures in lieu of the procedures set forth in Section 18 of the FTC Act, 15 U.S.C. 57a. Note that, because this rulemaking is not undertaken pursuant to section 18(a)(1)(B) of the FTC Act, 15 U.S.C. 57a(a)(1)(B), federal banking agencies are not required pursuant to section 18(f) of the Act, 15 U.S.C. 57a(f), to promulgate substantially similar regulations for entities within their jurisdiction. Nonetheless, the Commission plans to consult with the federal banking agencies in this proceeding, absent the findings required by the statute.

Commission intends to address unfair or deceptive acts and practices regarding mortgage loan modification and foreclosure rescue scams. The Commission appreciates this new authority and believes that it will be instrumental in increasing the protection that the agency can provide to mortgage borrowers and financially distressed homeowners.

IV. Enhancing FTC Consumer Protection Efforts

In addition to its work protecting consumers from foreclosure rescue and loan modification scams, the Commission has continued its overall efforts to protect consumers in the financial services marketplace. In particular, the FTC has focused on six additional critical areas: (1) mortgage servicing; (2) fair lending; (3) credit advertising; (4) debt collection; (5) debt settlement; and (6) credit repair.[29]

The FTC believes that its past efforts have provided important protections to American consumers in the credit marketplace. The agency, however, recognizes that it must do more. To that end, the Commission recommends that Congress make the FTC more effective by providing it with additional authority.[30] First, the Commission recommends that Congress authorize the agency to employ APA notice and comment rulemaking procedures to establish rules pursuant to the FTC Act that set forth unfair or deceptive acts and practices relating to all financial services.

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[29] For a more detailed description of recent cases brought in these areas, see the FTC's March 24, 2009 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at http://www.ftc.gov/os/2009/03/P064814consumercreditdebt.pdf.

[30] These recommendations are discussed in greater detail in the FTC's March 24, 2009 testimony before the House Committee on Energy and Commerce, Subcommittee on Commerce, Trade, and Consumer Protection, which is available at http://www.ftc.gov/os/2009/03/P064814consumercreditdebt.pdf.

Under the burdensome and time-consuming procedures for rulemaking set forth in Section 18 of the FTC Act, 15 U.S.C. 57a, Commission rulemakings typically have required from three to ten years to complete.[31] Second, the Commission recommends that Congress authorize the agency to obtain civil penalties for unfair or deceptive acts and practices relating to all financial services and authorize the agency to bring suit in its own right in federal court to obtain civil penalties. Third, in response to the current Balkanization of federal consumer protection oversight over financial services, several bills have been introduced and proposals offered under which there would be some type of overall federal regulator of financial services.[32] There are differences in these bills and proposals to rationalize the oversight system, and there are numerous challenging issues that would have to be resolved to implement these concepts. Because of its unequaled and comprehensive focus on consumer protection, its independence from providers of financial services, and its emphasis on vigorous law enforcement, we ask Congress to ensure that the FTC is considered as Congress moves forward in determining how to modify federal oversight of consumer financial services.[33]

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[31] For example, the proceeding to promulgate the FTC's Credit Practices Rule, 16 C.F.R. Part 444, using Magnuson-Moss procedures took almost ten years. In contrast, the proceeding to promulgate the FTC's Telemarketing Sales Rule, 16 C.F.R. Part 310, using APA procedures took one year.

[32] *See, e.g.*, Financial Product Safety Commission Act of 2009, S. 566, 111th Cong. (1st Sess. 2009); Consumer Credit Safety Commission Act of 2008, S. 3629, 110th Cong. (2d Sess. 2008); Consumer Credit Safety Commission Act of 2008, H.R. 7258, 110th Cong. (2d Sess. 2008); Cong. Oversight Panel, "Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability" (Jan. 2009) at 34; U.S. Department of the Treasury, "Blueprint for a Modernized Financial Regulatory Structure" (Mar. 2008).

[33] For a discussion of possible restructuring options, see Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer*, 157 U. Pa. L. Rev. 1, 98 (2008) (proposing "the creation of a single federal regulator – a new Financial Product Safety Commission or a new consumer credit division" in the Federal Reserve or the FTC).

Finally, the Commission asks that Congress provide additional resources to the FTC to increase its law enforcement activities related to financial services and to expand its critical research on the efficacy of mortgage disclosures and other topics.

V. Conclusion

Although the agency protects consumers throughout the credit life-cycle, the FTC recently has increased its focus on preventing harm to consumers who are already in debt and in financial distress. The FTC has used all of the tools in its arsenal – enforcement, consumer and business outreach, and policy development – to protect consumers from foreclosure rescue and loan modification scams. The Commission appreciates the opportunity to appear before you today to discuss the FTC's work.

Questions to the National Association of Realtors

Re a hearing of

The Subcommittee on Housing and Community Opportunity

"Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud"

On Wednesday, May 6, 2009

- According to your testimony, the National Association of Realtors believes that real estate professionals who are acting in their capacity as trusted advisors to their clients should also be exempt from the limitations placed on foreclosure consultants in H.R. 1231.
    - Are their rules of ethical and professional conduct that real estate professionals must abide by within their business conduct currently?

Response: REALTORS® are members of the National Association of REALTORS®. Only REALTORS® are subject to the ethical obligations of the REALTORS® Code of Ethics. Not every real estate broker and sales licensee is a REALTOR®. The professional activities of real estate brokers and sales associates generally - whether they are REALTORS® or not - are governed by the licensing authorities, and by the laws and regulations of the respective states as they apply to real estate professionals.

In addition, the professional conduct of every REALTOR® is governed by the Code of Ethics and Standards of Practice of the National Association of REALTORS®. A link to the 2009 Code of Ethics can be found at http://realtor.org/mempolweb.nsf/pages/2009Code

- If so, what rules currently exist that would require real estate professionals to charge only reasonable fees for actual services rendered?

Response: Since the early 1970's the NAR has, to minimize potential antitrust exposure of associations of REALTORS® and the multiple listing services they operate, taken the position that neither associations of REALTORS® or the multiple listing services will "fix, control, recommend or suggest" the commissions REALTORS® charge for brokerage services or the compensation REALTORS® offer to potential cooperating brokers for their services in cooperative real estate transaction.

- Your testimony references Minnesota's reconveyance statute. In talking about the statute, you highlight the three-day cancellation period as being particularly helpful for borrowers. How does this period assist homeowners? How was the three-day window settled on?

The three-day cancellation is consistent with existing Minnesota laws and also federal laws that allow for a three-day right of rescission on many consumer transactions. This period

allows for a break from the possible high-pressure sales tactics of unscrupulous companies. It gives consumers a chance to consider their options away from the business transaction.

- Would you increase or decrease the cancellation period's duration? Why?

We would not change the duration. Three days seems consistent with other laws, and appears to be working in Minnesota.

- You also reference Minnesota's exemption for realtors. Does the exemption remove realtors from the entire law, or only certain portions? If the exemption only applies to certain provisions, could you provide us with an overview of which ones?

REALTORS are exempted if they act within the rights, responsibilities and privileges of their licensing statute. If they offer services that allow the owner to retain possession of their home, then they are not exempt. The exemption reads: A "foreclosure consultant" DOES NOT include a person licensed as a real estate broker or salesperson under MN Statute 82 (real estate licensing statute) when performing acts which are regulated under Chapter 82, UNLESS the person is engaged in offering services designed to, or purportedly designed to, enable the owner to retain possession of the residence in foreclosure."

In addition, REALTORS® still must comply with relevant state law governing real estate business, and the REALTOR® Code of Ethics with respect to the requirement to "protect and promote the interests of their client".

- In your testimony, you mention that realtors provide important information on short sales and foreclosures. Aside from information, are there any other services that realtors tend to provide in foreclosure situations? Could you provide us with additional details on what kinds of services realtors provide for people facing foreclosure?

REALTORS® serve as trusted advisors and counselors to their clients, former clients, and even future clients in all types of housing situations – including foreclosures, loan modifications, and short sales. Sometimes it is for a fee – they are ordinarily paid a commission for closing a short sale – and sometimes it is not. REALTORS® and their state and local associations help educate consumers about legitimate foreclosure prevention programs, short sale options, and loan modification programs. REALTORS® are often aware of legitimate counseling resources they can refer their clients to, and if necessary, legal resources if a crime or violation has been committed. REALTORS® serve as a resource for their clients about these types of alternatives.

REALTORS® have provided this valuable information for years. Back in 2005, NAR (in conjunction with the Center for Responsible Lending) produced a brochure entitled, "Specialty Mortgages: What are the Risks and Advantages?" to educate REALTORS® and their clients about the danger of nontraditional "exotic" or "toxic" mortgage products. We produced similar brochures touting the benefits of fixed rate, fully amortizing mortgages, and of FHA mortgages. In 2007, we produced a brochure entitled "Learn How to Avoid Foreclosure and Keep Your Home" to provide educational information to REALTORS® and their clients about existing resources to prevent foreclosure and the risks of foreclosure scams.

- Could any of those services be provided if the fee was collected after the work was completed?

For the most part, REALTORS® are not paid up-front, and only after services are rendered.

- Your testimony referenced short sales. We heard earlier today about the growing number of predatory short sales, those types of transfers that leave the original homeowner in a deeper financial hole. What standards has your association enacted to ensure that its members are not engaging in these fraudulent short sales?

Response: Article 1 of the Code of Ethics requires REALTORS® to "protect and promote the interests of their client". It also acknowledges that while the "obligation to the client is primary" REALTORS® are nonetheless obligated to "treat all parties honestly".

- How do you police your organization?

Response: Enforcement of the Code of Ethics is a privilege and responsibility expressly delegated in the NAR's bylaws to the association's over 1400 state and local associations. Each association has committees and procedures in place to receive and adjudicate allegations of unethical conduct on the part of REALTOR® members. NAR establishes policies and procedures to guide state and local associations in these enforcement activities. They are detailed in the NAR *Code of Ethics and Arbitration Manual*.

- What sort of disciplinary actions, if any, might be taken against your members who are found to be associated with fraudulent mortgage rescue schemes?

Response: Penalties for violating the Code of Ethics start with letters of warning or reprimand and escalate from there depending on the severity of the offense and whether there have been prior violations. REALTORS® can re required to take relevant remedial education, can be fined up to $5,000, can have their membership suspended for up to one year, or can have their membership terminated.

ANSWERS OF MASSACHUSETTS ATTORNEY GENERAL MARTHA COAKLEY
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY

June 5, 2009

Answers to Written Questions Posed by the Subcommittee Regarding H.R. 1231

I respectfully submit the following answers to the questions posed by the Subcommittee on Housing and Community Opportunity regarding H.R. 1231, in response to the testimony which I provided on May 6, 2009, regarding said bill. I appreciate the opportunity to provide further testimony about this important, proposed legislation.

QUESTION:

- Hon. Coakley, your testimony addresses the concerns you have with H.R. 1231 as filed. However, you are in support of the amendment to H.R. 1231. Going back to the issues you have with H.R 1231 as filed, can you describe some of the cases that you have seen in Massachusetts involving lawyers engaged in unscrupulous conduct?

ANSWER:

Overall, we have observed two main types of fraudulent activity—schemes by those attempting to convince desperate homeowners to transfer ownership of their homes, and schemes by those charging upfront fees with a faulty promise to help homeowners obtain loan modifications. We have seen many attorneys involved in both types of schemes, apparently attempting to capitalize on their position of trust in the community and their knowledge about the field of real estate and mortgage loans, in order to take advantage of borrowers who find themselves in dire straits.

QUESTION:

- Some raise the argument that lawyers should be exempt from the limitations of foreclosure consultants because they should not be hindered from being able to charge advance fees, or retainer fees, for their services, which is a common industry practice. Based on your knowledge and experience, do you believe the amendment to HR 1231,

which would require attorneys to abide by the same regulation as other foreclosure consultants except for those in bankruptcy and foreclosure proceedings, would meaningfully interfere with a lawyer's right to charge advance fees?

ANSWER:

I do not believe that the amendment to H.R. 1231 would meaningfully interfere with a lawyer's right to charge advance fees in appropriate situations as set forth in the exceptions. The amendment allows attorneys to collect an advance fee or retainer for legal fees in connection with the preparation and filing of a bankruptcy petition or court proceedings to avoid a foreclosure. This language is similar to our state regulations which we have seen to be quite successful in curtailing this fraudulent activity. The prohibition against charging upfront fees for any other services related to foreclosure relief is necessary to protect vulnerable homeowners from abuses which have become all too prevalent during this economic downturn.

QUESTION:

- Since the finalization of Massachusetts' emergency regulations in August 2007 to protect consumers against foreclosure rescue fraud, how many cases has your office investigated? How many of these cases were prosecuted or resolved?

ANSWER:

Our office has investigated and continues to investigate a number of foreclosure assistance fraud cases involving conduct that violates 940 C.M.R. 25.00: Foreclosure Rescue Transactions and Foreclosure-Related Services, but I am not at liberty to identify the number or name of those entities that are the subject of an ongoing investigation. Through enforcement of our foreclosure rescue regulations, we have prevented foreclosure assistance fraudsters from obtaining homeowners' limited resources for bogus foreclosure assistance services. We have specifically prosecuted three cases under our foreclosure rescue regulations. One of these cases was resolved and resulted in full restitution to consumers of monies paid. With respect to the remaining two enforcement actions, we

have obtained preliminary injunctive relief prohibiting the defendants from engaging in unlawful conduct and prosecution of these matters continues.

QUESTION:

- Can you describe what, if any, collaboration the Massachusetts Attorney General's Office has with other state or federal agencies?

ANSWER:

As with any pattern of illegal conduct, my office has and will continue to cooperate with state and federal agencies to stop the spread of this fraudulent conduct. While I cannot detail all instances of cooperation and collaboration between the Massachusetts Attorney General's Office and federal and state agencies and law enforcement so as not to compromise ongoing investigations, my office has cooperated with the Federal Trade Commission in recent months to highlight the issue of foreclosure assistance fraud. In addressing the foreclosure crisis more generally, we have worked closely with the Massachusetts Division of Banks and the Office of Consumer Affairs.

In the case of fraudulent offers to provide loan modification consulting services, the majority of solicitations made to Massachusetts consumers presently come from outside of Massachusetts. We therefore welcome a federal law that seeks not only to prohibit this fraudulent conduct but also provides enforcement authority to both federal and state law enforcement in order to ensure that we adopt a comprehensive approach to law enforcement.

QUESTION:

- What has been the greatest challenge in prosecuting loan modification and foreclosure rescue fraud scams?

ANSWER:

There have been several challenges. The volume of these scams has grown exponentially as the economic crisis has worsened, as a result, it has been a challenge to act quickly to stop the bad

actors, and send the message that people offering foreclosure relief services to Massachusetts consumers must abide by Massachusetts law, whether or not they are located in the Commonwealth. It has also been a challenge to get the word out to consumers about their rights to negotiate with their lenders, how to avoid being victimized by disreputable parties, and how to seek help from non-profit organizations in their communities.

QUESTION:

- Are there are additional resources that would assist your efforts?

ANSWER:

It would be of great assistance to our efforts to have a federal statute that prohibits foreclosure assistance fraud on a national level, but affords comprehensive enforcement authority to both the federal government and state law enforcement.

QUESTION:

- In your testimony you note that your office took action against a person who was charging upfront payments of $1,000 for "assisting" homeowners in filing bankruptcy petitions in order to save their homes from foreclosure. Massachusetts law allows attorneys charge an upfront fee for the filing of bankruptcy petitions. Because of this exception, has the state seen an increase in frivolous bankruptcy claims like this?

ANSWER:

It is important to note that Massachusetts law, like the proposed amended version of H.R. 1231, prohibits *any* foreclosure consultant—whether or not they are licensed as an attorney—from taking an advance fee for providing foreclosure related services. In the enforcement action referenced in this question, the defendant was actually not an attorney licensed to practice in Massachusetts. He purported to help Massachusetts homeowners to avoid foreclosure by filing for bankruptcy; however, he filed incomplete and deficient bankruptcy petitions for these homeowners ultimately resulting in the homeowners' bankruptcies being dismissed and their homes remaining

subject to foreclosure. We think that the exceptions in the proposed bill, which mirror those in the Massachusetts statute, make sense—permitting attorneys to seek legitimate advance fees incident to filing bankruptcy petitions or defending foreclosure proceedings in court. To date, we do not have any information from the United States Bankruptcy Court about an increase in frivolous bankruptcy filings by licensed attorneys.

QUESTION:

- You note in your testimony that it is important to define "loan modification," "short refinancing" and "repayment plan." Why is definition of these terms important in legislation and how will such definitions serve to better inform consumers?

ANSWER:

The scams which have become prominent during the economic downturn follow certain patterns. It is important for legislation to be tailored to the different kinds of illicit conduct which is taking place—and to make clear for enforcement agencies and for our courts what types of conduct are proscribed. Clear definitions would also be an important step in educating consumers about what to look out for, and how to discern whether parties which solicit their business are complying with the law.

QUESTION:

- In your opinion, how will increased loan modifications and outreach by mortgage servicers decrease the instances of loan modification and foreclosure rescue fraud?

ANSWER:

It appears that not all lenders and servicers are engaging in meaningful loan modifications, using a net present value analysis, in order to arrive at an affordable monthly payment for the homeowner. Such an approach benefits homeowners and investors, and is also encouraged by the federal government's Making Home Affordable program. Additionally, we hear from distressed

homeowners that inadequate staffing by the loan servicers has led to ineffective management of call volumes, poor customer service and ultimately in many instances, deficient loan modifications or none at all. If servicers routinely offered appropriate loan modifications to reach affordable payments, and improved their customer service, then fewer homeowners would end up in dire straits and reach out to third party entities for assistance in saving their homes from foreclosure, which leaves them vulnerable to bad actors.

THE STATE BAR
OF CALIFORNIA

OFFICE OF THE CHIEF TRIAL COUNSEL

Scott J. Drexel, *Chief Trial Counsel*

180 HOWARD STREET, SAN FRANCISCO, CALIFORNIA 94105-1639 TELEPHONE: (415) 538-2063

June 5, 2009

By E-Mail to fsctestimony@mail.house.gov

Clerk
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Re: Responses to Questions to the California State Bar with Respect to the With Respect to the May 6, 2009 Hearing of the Subcommittee on Housing and Community Opportunity Entitled "*Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud*"

Dear Chairwoman Waters, Ranking Member Capito and
Honorable Members Of the Subcommittee on Housing and Community Opportunity:

I had the honor and privilege of testifying before your Subcommittee on May 6, 2009, at the hearing entitled "Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud." Thereafter, on May 21, 2009, I received a number of additional questions from the Subcommittee to which my response was requested. Pursuant to that request, following are the questions posed by the Subcommittee and my responses to them.

- **Of the 175 cases that the State Bar has investigated, how many of these have resulted in disbarment or other penalties?**

Once a disciplinary investigation is completed, there are a number of procedural steps that must be followed before formal disciplinary charges can be filed against an attorney, including (a) sharing a draft of the proposed charging document with the attorney; (b) providing him or her with an opportunity to meet with State Bar prosecutors to discuss the proposed charges; and (c) having an opportunity to participate in an "early neutral evaluation conference" which includes a judge from the State Bar's disciplinary court. Compliance with these procedural requirements can often impede our ability to quickly file disciplinary charges against these attorneys.

Nevertheless, to date, one of the attorneys engaged in a massive number of alleged fraudulent loan modification matters has resigned from the practice of law following the State Bar's successful petition to the superior court pursuant to Business and Professions Code section 6126.3 asking the court to take jurisdiction of his law practice. The State Bar recovered more than 2,300 loan modification files from this attorney's offices. In addition, the State Bar is close to file formal disciplinary charges against a second attorney.

- **What are the penalties that the California State Bar imposes on attorneys found to be in violation of the Professional Rules of Conduct or other ethical rules?**

Discipline imposed following a finding of one or more violations of the Rules of Professional Conduct or the disciplinary provisions of the State Bar Act (Cal. Bus. & Prof. Code, §§ 6000, *et seq.*) can range from (1) a private or public reproval; (2) a period of probation, subject to compliance with specified conditions; (3) a period of actual suspension from the practice of law ranging from 30 days to four years; to (4) disbarment. In addition, attorneys against whom disciplinary investigations or proceedings are pending may tender their resignations from the practice of law. However, the Supreme Court may decline to accept the resignation if any of a specified number of factors are present. (See rule 9.21, Cal. Rules of Ct.)

- **What has been the response to the ethics alert?**

The response to the Ethics Alert has been extremely positive. Through May 31, 2009, the Ethics Alert has been downloaded 53,581 times.

- **Do you believe the ethics alert was effective in deterring and stopping attorneys from Engaging in these types of fraudulent acts?**

Regrettably, there are some attorneys who know that their involvement in these loan modification services is fraudulent and improper but who nevertheless are willing to engage in the conduct because of the amount of money they receive. However, the Ethics Alert has been extremely effective with respect to those attorneys who are legitimately inquiring about whether it is appropriate to engage in these loan modification activities. Additionally, many attorneys have reported to the State Bar that they have been solicited by loan modification specialists to work with them and have called to inquire whether such arrangements would be appropriate. The Ethics Alert has been extremely effective in warning these attorneys, who want to engage in ethical conduct, about the dangers of becoming involved with non-attorneys in this area.

- **Ms. Moore's amendment to her bill, H.R. 1231, would exempt attorneys from the restrictions placed on foreclosure consultants, except in the case where a lawyer is entering bankruptcy or foreclosure proceedings. Do you believe this is sufficient to curb the practice of those bad attorneys who are engaging in these types of scams?**

Generally, the answer is yes. The most common type of loan modification fraud involving attorneys that we have seen in our discipline system involves attorneys, either acting alone or in connection with non-lawyer loan modification specialists, who collect an advance fee from the desperate homeowner and then either perform no services or ineffective services on the homeowner's behalf, usually resulting in the foreclosure of the homeowner's property. The prohibition on the collection of an advance fee by attorneys in a bankruptcy or foreclosure proceeding would require attorneys to more

carefully weigh the degree to which they can actually perform effective services on the homeowner's behalf and to actually perform those services before charging and collecting a fee for them.

- **Are there other instances where a lawyer should be allowed to accept advance fees when providing loan modification or foreclosure rescue services?**

In the California Legislature, there is a proposed amendment to Senate Bill 94 that would limit the prohibition upon attorneys' acceptance of advance fees for loan modification or foreclosure rescue services to residential property of four or fewer units. As a result, attorneys would be permitted to accept advance fees for loan modification or foreclosure rescue services relating to commercial properties or residential properties exceeding four units. The theory is that the owners of these properties tend to be more sophisticated than the typical homeowner and the issues involved in the loan modification or foreclosure rescue process may be significantly more complex.

- **What other alternatives exist to allow an attorney to collect payment for services if not by charging an advance fee?**

While many attorneys prefer to receive an advance fee against which they can bill as services are performed, there are many instances in which either no advance fee is paid or the advance fee has been exhausted. In those cases, the attorney typically tenders a monthly bill to the client for the services performed and the costs incurred during the preceding month or other billing cycle.

- **What effects would a total prohibition on upfront fees, with no exemption for attorneys, have on homeowners?**

A complete prohibition on the receipt of advance fees would likely cause a significant number of attorneys to decline to perform legal services for homeowners in the loan modification or foreclosure rescue area. These lawyers are legitimately concerned that homeowners in these circumstances have limited financial resources and may be become unable to pay their legal bills.

- **Are there any legitimate services to which they might be denied access?**

See above.

- **Do you believe fraudulent advertising – attorney or otherwise – is best combated through legislation, or through self-policing efforts such as those being taken by your bar association?**

At least insofar as attorneys are concerned, we are able to effectively combat fraudulent advertising through our Rules of Professional Conduct. However, the California rules may be more effective than similar rules in other jurisdictions, since the California attorneys are required to keep copies of all advertisements for a period of at least two years and the State Bar can demand copies of those advertisements and require the attorney or law firm to substantiate any statement made in the

advertisement. The California rule (rule 1-400, Cal. Rules of Prof. Conduct) also contains "standards" that the types of advertisements or their content that are presumptively in violation of the rule. The burden is then on the attorney to demonstrate that the advertisement in question does not violate rule 1-400.

- **Is effective legislation, allowing law enforcement agencies the ability to prosecute fraudulent advertising, already in place? Is there anything that could be done to strengthen these laws?**

I am not aware of any current legislation that allows law enforcement agencies to effectively prosecute fraudulent advertising in California. I am concerned that, given current economic realities for most state and local law enforcement agencies, first priority in terms of criminal prosecutions must usually be given to violent crimes and serious felonies.

Business and Professions Code section 6158.4 currently permits an action for declaratory and injunctive relief to be filed against an advertiser who violates the statutory provisions relating to lawyer advertising and allows for the recovery of up to $5,000 per violation. However, any recovery must be paid into the State Bar's Client Security Fund, which is a fund for the reimbursement of clients who have lost money through the dishonest conduct of attorneys. This limitation upon recovery significantly restricts the number of individuals who may be willing to undertake such a declaratory or injunctive relief action.

- **In your expert opinion, based on your experience with these fraud claims, how many non-delinquent homeowners – those who are diligently making their payments but are also looking to modify if possible – are taken in by these scams?**

It is impossible to put a number to it, but in my experience, there are many non-delinquent homeowners who are taken in by these scams. This is particularly true when the loan modification specialist or firm is making cold calls to homeowners to offer assistance with foreclosure rescue problems. When they learn that the homeowner is not delinquent, these loan modification specialist then immediately inquire about the homeowner's interest in obtaining a more advantageous interest rate on their home loan. If the homeowner responds affirmatively, they are then required to make an upfront payment and, typically, no loan modification services are performed.

- **What is the primary method that fraudulent consultants use to contact these homeowners?**

It appears that the primary contact is through (a) radio and television advertising; (b) billboards and signs; and, increasingly, (c) telephone calls to the homeowner's home telephone.

- **What additional resources would assist the California State Bar in better preventing foreclosure rescue and loan modification fraud by California attorneys?**

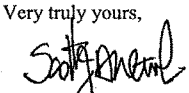
The State Bar of California is funded solely by the annual membership fees paid by individuals admitted to the practice of law in California. The State Bar's annual membership fee, which is established by the California Legislature, has remained essentially constant for the last 10 years. In the current economic environment, especially in California, obtaining an increase in the annual membership fee for attorneys is extremely difficult. Thus, the resources devoted to the investigation and prosecution of loan modification and foreclosure rescue fraud must be drawn from resources currently devoted to other matters. The State Bar has created a loan modification fraud task force consisting of five attorneys and five investigators. While more investigators and attorneys are needed, no additional staff is available because the State Bar will be otherwise unable to adequately investigate and prosecute other offenses.

Additional resources could potentially be provided in two ways. First, the State Bar has participated in meetings with representatives of other federal and state agencies. On May 7, 2009, representatives of the State Bar met at the U.S. Attorney's Office in Los Angeles with representatives of, among others, the U. S. Attorney, the IRS, the FBI, HUD, the Federal Trade Commission, the U.S. Bankruptcy Court, the State Attorney General's Office, the Department of Real Estate and numerous local prosecutorial offices. A cooperative approach to these loan modification and foreclosure rescue scams is essential. It is my understanding that if a formal task force is created for this purpose, some federal funds may become available to assist with this coordinated approach.

Second, if a federal grant or federal stimulus funds are available to assist the State Bar and other agencies to pursue these matters, it could significantly enhance our ability to attack the problem.

I hope that the foregoing responds to your request. Thank you again for the opportunity to testify in this important area. Please don't hesitate to contact me if I can be of any further assistance.

Very truly yours,



Scott J. Drexel
Chief Trial Counsel

SJD:dim

cc: Keo Chea, Counsel to Subcommittee on Housing & Community Outreach

Questions to the Financial Crimes Enforcement Network,
U.S. Department of the Treasury

Re a hearing of

The Subcommittee on Housing and Community Opportunity

"Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud"

On Wednesday, May 6, 2009

- According to your testimony, suspicious activity reports, otherwise known as SAR data was a leading indicator that mortgage loan fraud was a serious, escalating problem. SARs pertaining to mortgage fraud increased by 1400 percent between 1997 and 2005. And in a November 2006 study of SARs, "material misrepresentation/false statements" were reported on approximately 2/3 of SARs.

    - Of the mortgage fraud cases reported in the SARs, what percentage are due to foreclosure rescue fraud cases?

    - **To date, FinCEN analysts have identified over 600 reports since 2004 on *possible* foreclosure rescue fraud. This constitutes a low percentage of overall SAR filings (less than 1%). It is possible that the number of SARs arising from foreclosure rescue-related fraud activities may be higher since the activity is not always recognized by financial institutions and may coincide with other illegal activities. SAR filers may also use inconsistent terminology in reporting occurrences of foreclosure rescue frauds. As a result, FinCEN recently issued guidance to filers to ensure that these reports better describe instances of foreclosure fraud.**

    - What percentage makes up loan modification fraud?

    - **For reporting purposes, FinCEN classifies and captures "loan modification fraud" and "foreclosure rescue fraud" as the same type of criminal activity. Therefore, the answer to sub-bullet #1 applies to this question as well.**

- If these numbers are unavailable, how can we implement a systematic method to assess for foreclosure rescue and loan modification fraud?

  - **FinCEN has taken steps to address this by issuance of Advisory FIN-2009-A001, April 6, 2009 "Guidance to Financial Institutions on Filing Suspicious Activity Reports regarding Loan Modification/Foreclosure Rescue Scams. The Advisory provides a list of potential indicators to better assist financial institutions in recognizing loan modification/foreclosure rescue scams. In order to be of further assistance to law enforcement, filers were advised to use the term "foreclosure rescue scam" in the narrative portions of all relevant Suspicious Activity Reports filed. We believe that this will enable FinCEN and law enforcement to more accurately track future filings involving mortgage fraud and loan modification/foreclosure rescue scams.**

- Mr. Freis, in your opinion, what additional resources would help FinCEN better perform its current role in preventing foreclosure rescue and loan modification fraud?

  - **FinCEN works closely with our partners in the law enforcement and regulatory communities at both the Federal and State level to maximize efforts to shut down fraud perpetrators, increase our knowledge of how they operate, and proactively target those who would have previously gone unnoticed. It is premature to speculate on additional resource needs. In the meantime, however, FinCEN will continue to build upon our robust network of partners to maximize the joint effort to combat this illicit activity.**

- In your written testimony you state that FinCEN has "issued an advisory to help financial institutions spot questionable loan modification schemes and report that information for law enforcement purposes." How can financial institutions spot these schemes? What should alert a financial institution that a homeowner may be falling victim to loan modification fraud?

  - **The following points contain examples of information received from a customer or otherwise that may indicate the presence of a foreclosure rescue scam and could help alert financial institutions to these schemes:**

    - **A homeowner tells the mortgage servicer, perhaps upon receiving an overdue notice, that he/she has been making payments to a party other than the mortgage holder or servicer. The homeowner may have been tricked into signing a quit claim deed for the benefit of the perpetrator of a scam or told to make**

payments to a third party (in actuality, a con-artist), who would allegedly forward them to the lender.

- **A homeowner says that he/she has hired a third party, perhaps advertised as or alleged to be a "foreclosure specialist" or "mortgage specialist," to help him/her avoid foreclosure or help renegotiate the terms of his/her mortgage with the lender. This may be suspicious if the homeowner indicates that the third party:**
    - **Charged up-front fees for foreclosure rescue or loan modification services;**
    - **Only accepted up-front payment by official check, cashier's check or wire transfer;**
    - **Used aggressive tactics to seek out the homeowner by telephone, e-mail, mail or in person;**
    - **Pressured the homeowner to sign paperwork he/she didn't have an opportunity to read thoroughly or that he/she didn't understand;**
    - **Guaranteed to save the home from foreclosure or stop the foreclosure process "no matter what;"**
    - **Claimed the process will be quick with relatively little information and paperwork required from the homeowner;**
    - **Offered to buy the house and then rent it back to the homeowner;**
    - **Falsely claimed to be affiliated with the government. (Perpetrators of scams often use names or symbols that mimic Federal and state programs or falsely suggest that they offer legal services or are affiliated with an attorney or law firm); or**
    - **Instructed the homeowner not to contact the lender, a lawyer or financial counselor.**
- **A homeowner says he/she paid someone to assist in getting help from the right Federal affordable housing program.**
- **A homeowner maintains that he/she does not need to pay a mortgage because the loan contract is invalid, or the customer attempts to pay with a bogus sight draft, Federal Reserve Bank/Treasury letter, or check that accesses a "Treasury Direct Account." Such homeowners may be committing fraud or may have been duped by individuals who claim government-related contracts are illegitimate. Other homeowners may have unsuspectingly paid for illegitimate or bogus pay-off documents.**

- You note that FinCEN is working to shut down fraudulent companies more quickly than before. What barriers are currently preventing FinCEN and other law enforcement agencies from taking immediate action to shut down fraudulent companies?

    - **As a law enforcement support agency, FinCEN does not have civil or criminal authority to unilaterally take action against, or shut down, a company. Rather, FinCEN concentrates on providing investigative leads and case support to State and Federal law enforcement authorities, proactively targeting and identifying potential suspects through review of Suspicious Activity Reports (SARs), and networking and deconflicting law enforcement efforts so that investigative and prosecutorial resources can be maximized. While FinCEN is not in a position to address your underlying question on behalf of the law enforcement community, our collaboration with involved parties, including responses to an informal e-mail survey FinCEN undertook, as well as our proactive review and analysis of SARs, revealed some commonality of concerns, specifically:**

        - **The nature of the businesses involved, which is often nebulous, with little more than a couple of individuals, who often use different names for themselves and frequently change the names of their companies, making them difficult to identify and/or close down.**
        - **The transient nature of many of these businesses, which permits them to move and set-up shop in new jurisdictions when action is taken by one investigative authority.**
        - **The frequently multi-jurisdictional aspects of these investigations, which can make it difficult to utilize law enforcement tools and to coordinate efforts.**
        - **The varying civil and criminal laws under which action is permitted, the variety of organizations that have authorities for pursuing actions, and the low dollar aggregates for some of the frauds.**

- According to the guidance FinCEN provided to financial institutions on identifying suspected loan modification fraud, an indicator of such fraud may be a homeowner telling the servicer that they are making payments to someone else or that someone has told them to stop making payments altogether. What types of notices can servicers provide to borrowers that would be helpful in alerting them to these types of scams?

    - **In developing the Advisory, FinCEN worked with the appropriate Federal regulatory agencies to highlight the issue. Some of these agencies, including the Office of Thrift Supervision (OTS), the Office**

of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve, have issued separate guidance to financial institutions about educating their customers on this issue.

- **FinCEN has advised financial institutions that they may wish to caution their customers to avoid any business or person that seeks to charge up-front fees for services related to the new Treasury loan modification programs.**
- **The advisory also notes that further information about the various plans available to homeowners is available at www.financialstability.gov or by contacting the Homeowner's HOPE Hotline at 1-888-995-HOPE (1-888-995-4673).**
- **If a financial institution becomes aware of a customer's unintentional involvement in a foreclosure rescue scam, the customer may be referred to the Federal Trade Commission website, www.ftc.gov. This site contains a publication designed to educate homeowners on mortgage foreclosure rescue scams and also offers contact information for those who may have already fallen victim to a scam. Financial institutions may also consider referring customers to state or local authorities.**

- What kinds of financial institutions are required to file suspicious activity reports (SARs)? Should all mortgage servicers be required to file these reports? If not, how can we identify loan modification fraud that may be affecting homeowners with loans serviced by companies that are not required to file SARs?

  - **FinCEN has promulgated SAR reporting regulations for a number of financial institutions that have anti-money laundering (AML) program requirements, including: mutual funds, insurance companies, futures commission merchants and introducing brokers in commodities, banks, brokers or dealers in securities, money services businesses, and casinos. (See 31 CFR 103.15 – 103.21.)**

  - **Presently, there are no regulations that require independent mortgage servicing companies to file SARs. In the near term, however, FinCEN intends to gather information on the possible impact and pros and cons of applying AML program and SAR reporting regulations to non-bank residential mortgage lenders and originators. If FinCEN issues a notice in the *Federal Register* to solicit public comments on the topic, FinCEN expects to receive comments on how FinCEN should define or limit the scope of any such regulations. Accordingly, mortgage servicing companies and other companies either directly or peripherally involved in mortgage lending, as well as any other interested party, will have an opportunity to submit comments to FinCEN that may address the issue of**

whether FinCEN should apply SAR reporting requirements to mortgage servicing companies and/or other companies. FinCEN understands that many diversified financial institutions that have affiliations or business arrangements with mortgage servicing companies have established AML programs and procedures governing the lawful exchange of information relating to suspected mortgage fraud and other financial crimes, as part of enterprise-wide AML and anti-fraud programs.

- Since mortgage fraud reporting is not mandatory, how can we ensure that we have accurate data to assess the issue?

  - **In order to assist law enforcement in its efforts to target this type of fraudulent activity, the FinCEN advisory requests that, if financial institutions become aware of this type of activity, they include the term "foreclosure rescue scam" in the narrative portions of all relevant Suspicious Activity Reports filed. We further requested that the Suspect/Subject Information Section of the Suspicious Activity Report include all information available for each party suspected of engaging in this fraudulent activity – including information such as individual or company name, address, phone number and any other identifying information.**[1]
  - **In many circumstances, the homeowner is a victim of the scam and therefore should not be listed as a suspect unless there is reason to believe the homeowner knowingly participated in the fraudulent activity. When the homeowner is simply a victim of a scam, we have requested financial institutions include all available information in the narrative portion of the Suspicious Activity Report about the homeowner and his or her property in order to assist law enforcement in investigating these potential crimes.**
  - **Requesting that financial institutions include specific terms in the narrative portion of their Suspicious Activity Reports will allow FinCEN, and other law enforcement analysts, to more quickly query the data and accurately assess the issue.**
  - **FinCEN is continually monitoring for SARs on this issue and plans to issue updated Advisories to financial institutions as more information becomes available. We are also working closely with state and federal law enforcement and will serve as a network/deconfliction center for any agency that wants to submit the names of suspects to FinCEN.**

- How are financial institutions working to identify loan modification fraud affecting homeowners with limited English proficiency?

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[1] If multiple subjects are involved and the financial institution is filing a paper form, the filer should attach an additional copy of the subject information section of the report for each subject.

- **FinCEN is not in a position to speak on behalf of financial institutions' efforts to improve awareness of potential loan modification fraud for individuals with limited English proficiency. As a general matter, however, educating the public is a critical component of combating this abuse, and in addition to the outreach being done by the financial institutions, non-profits – such as NeighborWorks America – are providing crucial awareness of suspicious modification fraud indicators in languages other than English, which certainly helps to advance the effort of spreading awareness to all communities in the United States.**

Answers to Questions to the National Consumer Law Center

Re a hearing of

The Subcommittee on Housing and Community Opportunity

"Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud"

On Wednesday, May 6, 2009

Submitted June 5, 2009

- **In your testimony, you offer several recommendations for Congress, including the suggestion that attorneys should be generally exempt from advance fee requirements but that the exemption should be drawn to avoid evasions for work by non-lawyers.**
  - **How would you suggest this exemption be drawn to avoid evasions for work by non-lawyers?**
  - **Do you agree with Ms. Moore's amendment to her bill, H.R. 1231, which provides for an exemption for attorneys except in the cases where an attorney is in bankruptcy filings or court foreclosure proceedings?**
  - **Are there other instances where it would be detrimental to a lawyer's profession to be prohibited from charging advance fees?**
  - **Can you discuss the alternatives that attorneys can pursue to collect payment if they are unable to charge advance fees?**

A: An exemption for attorneys must be drawn carefully to walk a fine line. On the one hand, private and nonprofit attorneys, including NCLC, charge for legitimate legal advice, analysis and assistance aimed at, but not guaranteeing, avoiding foreclosure. On the other hand, both nonlawyers and lawyers have used the guise of legal work to cloak nonlegal work provided by nonlawyers, or practices that seem more designed at extracting a fee than achieving a true loan modification. We believe that there should be an exemption for attorneys subject to qualifications such as the following:

(1) The exemption applies only to attorneys and law firms, and not to work provided by other firms, even if the company employs attorneys, includes attorneys among its owners, or offers legal work in conjunction with an attorney. The law firm must be solely composed of and solely controlled by attorneys and cannot split fees with nonattorneys.

(2) Attorneys and law firms are entitled to the exemption only for work in a state in which they are licensed to practice law; only for work within the scope of that license; and only as long as they are fully in compliance with the state's licensing requirements, ethical guidelines, and any other applicable requirements.

(3) The only advance funds permitted are advance fees or retainers that are placed in a client trust account, regardless whether such accounts are mandated by state bar rules, and the attorney earns the fee only as work is performed as agreed. The homeowner must be permitted to cancel the retainer agreement at any time and receive a refund of any unearned fees.

Though it might be appropriate to provide a safe harbor for litigation, such as work in connection with bankruptcy filings or court foreclosure proceedings, the amendment to Ms. Moore's bill is too narrowly drawn and the exemption should not be limited to litigation. Our office, for example, charges for loan document analysis that results merely in an opinion on whether the consumer has viable legal claims. Similarly, it is within the traditional, legitimate scope of legal practice for individuals to retain attorneys to write demand letters and to engage in other efforts to negotiate out of court settlements, even if the attorney does not intend to litigate. Some private attorneys who have been at the forefront of attacking predatory lending and pursuing foreclosure rescue scams offer these services and should be permitted to continue doing so.

Attorneys, including NCLC, accept advance fees for these services, and likely would not offer them if advance retainers were prohibited. This type of work is not amenable to contingency fee arrangements, as it does not typically result in a payment from which the fee can be taken. A homeowner who is in foreclosure cannot be counted on to pay a bill for legal services after the fact.

It would also be inappropriate to condition payment for attorneys on actual achievement of a loan modification or success in avoiding foreclosure, as attorneys cannot guarantee success, and may in fact only have agreed to analyze a claim or write a demand letter.

- **According to your testimony, you address the concern that a homeowner's biggest obstacle may be having real access to a responsive servicer or live person. This results in homeowners often feeling overwhelmed with long wait times to reach their servicer and therefore, willing to pay up to $1000 or more to a for-profit foreclosure consultant who promises to successfully re-negotiate their loans or prevent foreclosure for them.**
    - **Do you believe that the President's Making Home Affordable program will help address this issue and encourage more servicers to respond to borrowers?**

A: While we believe that the new program is a significant step forward from previous approaches, and that many of the guidelines in the program are constructive, the program is limited by its voluntary nature, by limited oversight of servicers, and by the sheer scope of the crisis. While many of the large servicers have agreed to participate, it is clear that the program guidelines are not resulting in significant numbers of loan modifications for eligible borrowers. In fact, advocates for homeowners across the nation report that some servicers are trying to avoid the terms of the program by promoting

alternative approaches to homeowners. Moreover, while the program limits a servicer's ability to foreclose until after a loan modification review, it does nothing to halt the foreclosure process, which often requires several steps before the actual sale. As a result, foreclosure costs continue to pile up even though the loan is being reviewed for modification. The longer it takes for the loan modification review, the more costs are charged to the homeowner's account and the less likely it is that an affordable loan modification will be possible. We continue to believe that a mandatory requirement for affordable loan modifications within certain parameters is necessary.

- **Ms. Saunders, one of the examples you cited in your testimony involved the Mendez family from Watsonville, California who responded to a Spanish radio ad from Saving California, a company that promised to lower their mortgage payment, but ended up taking $3500 and providing no service.**
    - **Based on your knowledge and collaboration with other community groups, can you further discuss the need for multi-lingual outreach materials for minority communities?**

A: It is critical for community-based organizations (CBOs) to have multi-lingual outreach material to effectively distribute information on foreclosure rescue scams to all communities. Those that do not speak English well are often primary targets for fraud and deception because they have less access to high quality and timely information. We need a strong public-private investment in outreach materials available in the most popular languages to compete with the ubiquitous advertisements from scammers. For example, National Council of La Raza (NCLR) has found that marketing through local Spanish language radio stations and newspapers is a highly effective way to reach the Latino community. However, community leaders often lack the time, expertise, or standardized resources to necessary to maximize this outlet. While some community-focused mediums will offer free ad time or space, many require payment. Moreover, outreach material is translated into Spanish but not into the 40+ Asian American Pacific Islander (AAPI) languages. Strategic investment in minority-serving CBOs is critical to delivering effective multi-lingual outreach material to vulnerable minority communities.

- **What communities seem to be the most impacted or targeted for loan modification or foreclosure rescue fraud?**

A: Foreclosure rescue scams are following the same pattern as predatory lenders by targeting minorities, individuals with limited English proficiency, the elderly, and low income neighborhoods. Communities heavily impacted by the foreclosure crisis, which are disproportionately minority communities, are being hit hard by foreclosure rescue scam artists. Latino and AAPI families may be cut off from mainstream media and are less likely to have access to outreach cautioning homeowners about foreclosure rescue scams.

- **Do you have recommendations to better improve outreach to minority communities?**

A: Create a robust national campaign against foreclosure. The federal government and private stakeholders, such as lenders, servicers, and counselors, must come together to launch a national campaign that would combine social awareness, emergency assistance, and strong enforcement against fraudulent rescue scams. Public Service Announcements (PSAs) in various media and languages can build awareness of what to do in the case of mortgage delinquency and where to turn for help. The campaign should also direct families to HUD-approved counseling agencies in their neighborhoods for further assistance. To complement the public education piece, a national campaign must include strong enforcement action against predatory foreclosure rescue operations. These scams take advantage of underserved communities at their most vulnerable point. Without strong enforcement action against these predators, education and referral efforts will not be successful.

Provide funding for minority-serving organizations to develop marketing strategies for minority communities. In addition, multi-lingual outreach material should be accessible to local groups as well as funding to distribute outreach material to appropriate media outlets.

- **You recommend tying payment for modification services to the results achieved. The problem is that sometimes these schemes will advertise modifications, but deliver a modified repayment schedule instead. What consumer protections do you think would be required to make sure consumers understood the differences between these two services, and to make sure that they only pay for the more effective modification?**

A: As with conventional forms of credit, disclosures to the consumer in connection with a complex transaction will not ensure that informed choices can be made. Servicers—the central actor in this process—must be required to offer workouts that are sustainable in the long-term. If a servicer itself faced consequences for engaging in inadequate workout efforts – such as an inability to foreclose – consumers would be able to obtain useful workouts directly from their servicers rather than being attracted to third party modification services that offer short-term, counter-productive agreements. Though we believe that the most essential reforms must be aimed at servicers, to the extent that for-profit loan modification firms are regulated, they must not be permitted to charge a fee unless their efforts result in an affordable modification that is sustainable in the long run. Affordability of loan modifications is comparable to the considerations at issue for loan originations. The terms must be affordable by the consumer for the life of the loan, where affordability is determined based on certain debt to income ratios and residual income analysis. A federal minimum standard for such analyses should be established that states should be able to supplement. If a loan modification is not possible that meets these criteria, then the consumer gets little if any benefit worth paying for.

- **You also mention that the loan modifications should be sustainable and affordable. Who do you think should monitor whether loan modifications fit those goals? Would this be done at the federal or state level?**

A: The FTC, states and individual homeowners should all be able to take action against loan modification firms that charge for work that does not result in a sustainable, affordable modification.

- **In your opinion, would a reporting requirement be useful? If so, who should be filing reports? Would the modification companies be required to report data? What kind of data?**

A: Servicers themselves should be reporting loan modifications and other loss mitigation outcomes (as well as foreclosure rates). While data is being collected in association with various programs, broad data collection is still needed. The small amount of available data has been enlightening and industry-wide data available to the public would provide some needed sunlight on a generally opaque process. In addition, the need for transparency also applies to the MHA program itself. Homeowners and their representatives are not able to measure their eligibility for the program because the Net Present Value analysis (such as that available through the FDIC Loan Mod In A Box Excel Spreadsheet) is not available to the public. A central repository of data from loan modification firms would also be helpful. Firms should be required to report the percentage of consumers who receive loan modifications and the details of those modifications. The reports should include, for each customer, the fee collected, whether a modification was obtained, and the basic before and after terms of the modification (interest rate, principal and monthly payment, as well as duration of the modification, i.e., whether it is temporary or permanent).

- **In your testimony, you note that the state of California passed mortgage foreclosure fraud legislation in 1979. Yet, thirty years later the problem persists. What caused the law to be ineffective? Are those flaws state-specific, or should we look to address the same types of weaknesses in our own legislative efforts?**

A: The problems challenging the California legislation, which are common to other states, are:

(1) The statute exempts attorneys.

(2) The protections only apply once a notice of default has been recorded. If a homeowner responds to an advertisement before a default is recorded, the Act does not apply. This leaves a large class of struggling homeowners vulnerable to sham offers.

(3) The penalties are too weak. The $1,000 to $3,000 in damages that homeowners suffer is not sufficient to interest an attorney. The attorneys' fees provision helps, but attorneys may fear that a court would be reluctant to award significant attorneys' fees on top of only modest damages. A significant statutory penalty would help.

(4) The scammers tend to disappear once they are sued and collection is difficult. It is easy for firms to scam for a while and then suddenly close down, disappear, and reopen under a different name. However, California recently amended its law to require posting of a $100,000 bond, which should help, though there are concerns that compliance with the bond requirement may be viewed as state endorsement.

(5) Law enforcement resources are inadequate to the task. I have been told that in California, the State Bar alone receives 900 consumer complaints a month about loan modification scams involving attorneys. The attorney general's office and district attorneys' offices in many parts of California are pursuing enforcement but are overwhelmed by volume.

- **In your testimony you discuss the other dangers associated with these frauds. In addition to up-front fees you note that consumers are also charged for attending loan seminars and for "audits." In your opinion, what reforms would we have to enact to also prevent these types of schemes? Do you think consumer education would be enough, or are we looking at additional legislation?**

A: Fees for worthless seminars may not be covered by the proposed bill but might be difficult to address. Those offering audits may be within the bill's definition of "foreclosure consultant," which is anyone who offers a service that the person represents will prevent, postpone, or reverse the effect of a foreclosure. Tightening up the exemption for attorneys to exclude services offered by anyone other than an attorney or law firm would reduce the incentive for non-legal firms to offer attorney "audits."

- **Your testimony mentions questionable short sale tactics, where the real estate broker and the new buyer collude to the detriment of the seller. What motivations do lenders have to enter these transactions? Why would they choose this type of hybrid-foreclosure over a standard mortgage modification? Does it matter if the property is held by the lender or by a servicer?**

A: Loan holders sometimes are also victims of scams. In the "flipping" version of the scam – where the rescuer puts in a low bid on the property and then flips it to the true buyer at a higher cost – the lender is unaware of the second sale and the true sale price. In the "ignore the due-on-sale clause" version of the scam, where the property is sold to a buyer without clearing title or satisfying the due-on-sale clause, the lender is unaware of the sale at all or the fact that the homeowner has relinquished possession. The servicer is in the same position as the holder of the loan – unaware of the full scope of these transactions.

- **You advocate that there should be exceptions to blanket prohibitions on upfront fees. You specifically reference attorneys who initiate bankruptcy proceedings. How do we know that creating this exception for attorneys would not lead to an increase in unnecessary or uninformed bankruptcy filings by fraudulent lawyers looking to take advantage of the loophole?**

A: The qualifications listed above to an attorney exemption will cut down on the opportunities for evasions. As described above, the exemption needs to be broader than simply bankruptcy filings. But regulation of attorney services is best left primarily at the state level. This bill, aimed at foreclosure consultant scams, cannot solve all of the problems of attorneys who charge fees for substandard or fraudulent legal work. Efforts to make the attorney exemption too narrow will backfire by harming the very attorneys who have been at the forefront of helping homeowners who have been the victims of predatory lending or foreclosure rescue scams.

Questions to the Federal Trade Commission
Re a hearing of
The Subcommittee on Housing and Community Opportunity

"Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud"

On Wednesday, May 6, 2009

1. **Ms. Twohig, according to your testimony, you state that the FTC has sent 71 warning letters to companies for marketing potentially deceptive mortgage loan modification and foreclosure assistance programs.**

   - **What has been the response by the companies to the warning letters?**

Many of the companies have responded by removing their websites entirely or by modifying the claims the staff identified as problematic in the warning letters. However, they have not necessarily stopped all practices that are likely to mislead consumers. The staff will continue to closely monitor the websites of these and other companies, and follow-up with investigations and pursue law enforcement actions where appropriate.

   - **How is the FTC following up on these companies?**

The agency continues regular monitoring of the companies' websites. The staff considers this information, consumer complaints, and other investigatory information gathered about these companies and other companies offering loan modification and foreclosure rescue services in making decisions about where to target our law enforcement resources to provide the most protection for consumers.

For example, the FTC recently obtained a temporary restraining order against an Internet-based operation that pretends to operate MakingHomeAffordable.gov, the official website of the federal Making Home Affordable program for free mortgage loan assistance. It appears that some of the companies that received warning letters in the Surf may be affiliated with this operation. The FTC is further investigating to see if deceptive practices by any of these companies continue and will take enforcement action as needed.

I believe that the combination of warning letters and targeted law enforcement is an effective use of the FTC's resources to achieve compliance.

   - **Are these companies required to show proof to the FTC of the legitimacy of their operations?**

Companies the Commission investigates and takes law enforcement action against must provide information requested in the course of the investigation or litigation, which would

typically include information about whether they performed the services promised to consumers. The staff typically conducts investigations without notice to the company in order to use undercover techniques to gather evidence to support our request for a temporary restraining order or preliminary injunction. In other instances, the Commission will issue subpoenas to targets to obtain information directly from the targets before assessing whether to file a law enforcement action.

2. Many state statutes that regulate foreclosure rescue and loan modification fraud exempt attorneys.

- **Based on some of the cases that the FTC has seen, do you think attorneys should be regulated in regards to their involvement in foreclosure rescue and loan modification fraud? Why or why not?**

The FTC's law enforcement experience in this area indicates that some attorneys are involved in foreclosure rescue and loan modification activities and may be deceiving consumers about the services that they will receive. For example, in the Federal Loan Modification Law Center case, the Commission's complaint alleges that the deceptive practices were directed by an attorney licensed to practice in California. Nevertheless, there also may be a role for ethical attorneys to provide legitimate legal services to consumers trying to avoid foreclosure. To the extent that federal statutes or regulations address foreclosure rescue and loan modification services, I believe that any exemption that may be carved out for attorneys should be narrowly drawn. For example, attorneys doing pro bono work likely should be exempt. On the other hand, for example, attorneys providing ethical and legitimate legal services typically do not employ telemarketers, and they should not qualify for an exemption.

- **Do you have other suggestions to ensure that all deceptive actors are prevented from engaging in these types of fraud?**

The Commission is still in the process of considering how best to promulgate rules pursuant to the Omnibus Appropriations Act regarding foreclosure rescue and loan modification. As part of that process, the Commission requested public feedback on this issue in an Advance Notice of Proposed Rulemaking (ANPR) announced on May 29, 2009, including feedback from our state partners who have enacted legislation regulating this industry. (See Question 4, below, for more information on the ANPR.) In addition, the Commission will continue to devote substantial resources to enforcement and consumer education initiatives in this area to stop fraud and deception and to ensure that consumers are armed with the information to spot and avoid bad actors in the mortgage relief industry.

3. **Minorities and those with limited English proficiency may be especially vulnerable to loan modification and foreclosure scam artists.**

- **What outreach efforts are being made to ensure that minority groups and limited English proficient communities are included in community outreach?**

- **What languages are the materials provided in?**

The FTC disseminates consumer information in English and Spanish through the web, through the media, and an information network of partners. The agency has created information about foreclosure rescue and loan modification scams in print, in audio, and online. It also has been working through NeighborWorks America to distribute informational flyers and bookmarks in English and Spanish at borrower events across the nation. It also is working through the Homeownership Preservation Foundation, a nonprofit member of the Hope Now Alliance of mortgage industry members and HUD-certified counseling agencies to distribute those materials directly to people who need them. Some large servicers are playing the audio messages that the FTC has recorded when their customers are on hold; others are linking to the special section on foreclosure rescue scams on the FTC's financial downturn microsite, www.ftc.gov/moneymatters; and still others have reprinted the agency's materials to distribute to their customers.

Since February 2009, the FTC warehouse has distributed 36,500 copies of the flyer and 41,200 copies of the bookmark in English, and 31,700 copies of the flyer and 40,000 copies of the bookmark in Spanish.

The FTC's microsite, www.ftc.gov/moneymatters, has had 120,000 accesses since it was launched in March. The Spanish version, which was launched in April, has had about 2500 accesses to date. Another publication, Foreclosure Rescue Scams: A Potential Stress for Homeowners in Distress, has been disseminated widely through law enforcement and consumer protection partners (since February 30,000 in English and 5,000 in Spanish).

The May issue of Ojo, our Spanish-language newsletter, featured an article on foreclosure rescue scams. Ojo goes to more than 1100 community-based organizations across the nation. In addition, the FTC is working with a number of national and community-based organizations with African American constituencies to disseminate helpful information about recognizing foreclosure rescue and loan modification scams.

The Commission has disseminated public service announcement scripts to radio stations and classified ads to newspapers in the cities hardest hit by mortgage foreclosures during the last year, including Bakersfield, Fresno, Riverside-San Bernardino, and Stockton; Atlanta; Detroit; Las Vegas; and Cleveland. The PSAs were in both English and Spanish.

The FTC is preparing to release an informational video on YouTube in Spanish and English that features people who faced foreclosure who were helped by legitimate foreclosure counselors. And it is working to train counselors who talk to consumers on the HomeOwners

Hotline (888-995-HOPE) to recognize the signs of foreclosure rescue scams and report them to the FTC's Consumer Sentinel.

- **What benchmarks are in place to assess whether the outreach efforts are effective?**

The FTC tracks visits to its websites that provide information online, tracks usage of our hard copies of consumer information, and pays close attention to what consumers report to counselors on our toll-free help line. The agency aims to be responsive to the experiences consumers report.

4. **In your testimony, you state that the FTC has new rulemaking authority to prohibit unfair or deceptive practices with respect to mortgage loans. This new legislation allows the FTC to use the relatively streamlined notice and comment rulemaking procedures under Section 553 of the APA in promulgating these rules.**

- **Can you describe in more detail how the rulemaking authority will affect FTC's ability to take remedial action against fraudulent actors?**

The 2009 Omnibus Appropriations Act directs the FTC to commence an APA rulemaking proceeding relating to unfair and deceptive acts and practices with respect to mortgage loans. On May 29, 2009, the Commission announced two ANPRs requesting public feedback on a variety of issues relating to mortgage loans. The Commission anticipates that this rulemaking will address scams involving mortgage loan modification and foreclosure rescue, as well as other mortgage lending issues on which rules might be beneficial to consumers. Violators of the rules promulgated under the Act will be subject to civil penalties.

- **How will the FTC benefit from streamlining the notice and comment procedures?**

Rulemaking will allow the Commission to address these issues in a more comprehensive and systematic way, compared to our current case-by-case approach. With the more streamlined APA notice and comment procedures, the FTC will be able to respond expeditiously and effectively to the challenges that consumers face. Using the burdensome, complicated, and time-consuming procedures of Section 18 of the FTC Act ("Magnuson-Moss procedures"), FTC rulemakings typically have taken anywhere from three to ten years to complete.

- **What are some of the disadvantages of not requiring the FTC to follow the rulemaking process under the standard, Magnuson-Moss procedures?**

I see no disadvantages to having the FTC use APA rulemaking procedures instead of the Magnuson-Moss procedures. The Magnuson-Moss procedures were designed to ensure that the Commission conducts a complete and careful analysis of information before it issues rules declaring acts or practices as unfair or deceptive. The FTC has demonstrated repeatedly in recent years that it can conduct careful and thorough analyses pursuant to APA rulemaking

procedures. As you know, Congress has empowered the FTC to promulgate a variety of rules using APA rulemaking procedures to address a range of consumer protection problems, and these rules have been well-supported and effective. For example, the FTC used APA rulemaking procedures to promulgate the Telemarketing Sales Rule, which is widely regarded as an important and effective regulation. In addition, any such rules issued by the FTC would be subject to the same standard of judicial review under the APA as similar rules issued by other agencies. Thus, the courts serve an important oversight function in ensuring that any agency using APA rulemaking authority does a careful and thorough job.

5. **Furthermore, the FTC recommends that Congress allow the FTC to use APA notice and comment rulemaking procedures to establish rules that set forth unfair or deceptive acts and practices relating to all financial services.**

   - **Would this create a conflict of jurisdiction between the separate federal agencies currently working on foreclosure rescue and loan modification fraud?**

   - **Would this result in separate federal agencies having overlapping jurisdiction over the handling of these types of cases?**

The FTC has recommended that Congress allow the FTC to use APA rulemaking procedures to establish rules that set forth unfair or deceptive acts or practices under the FTC Act relating to all financial services for entities under its jurisdiction. With respect to foreclosure rescue and loan modification frauds, the entities providing those services are under the FTC's jurisdiction for purposes of enforcing the FTC Act. To the extent that other federal agencies are enforcing statutes other than the FTC Act against providers these services, the staff is coordinating closely with them and deferring where appropriate, particularly to criminal law enforcers.

6. **You also raise concern in your testimony about Congress implementing a federal oversight system of consumer financial services.**

   - **Can you elaborate on some of the concerns that the FTC has?**

   - **What recommendations do you suggest for the implementation of a federal oversight system?**

As these discussions continue about changes to the oversight system for consumer financial services regulation, the Commission has testified that it urges this Subcommittee and the Congress to consider how best to utilize the Commission's unparalleled expertise in consumer protection. The FTC has extensive experience enforcing consumer credit laws and a wide variety of other consumer protection laws, as well as working successfully with state law enforcers and regulators. The Commission is recognized as a leader in educating consumers and businesses on a wide range of financial services topics. The agency has conducted critical research and policy development in the financial services sector, including seminal research on

mortgage and other disclosure issues.

Because of its unequaled and comprehensive focus on consumer protection, its independence from providers of financial services, and its emphasis on vigorous law enforcement, the Commission asks Congress to ensure that the FTC is considered as Congress moves forward in determining how to modify federal oversight of consumer financial services.

7. **According to your testimony, there are three main warning signs that trigger FTC's law enforcement actions regarding foreclosure rescue and loan modification schemes, which include, companies that "guarantee" successful loan modifications, companies that charge up front fees, or when these companies provide little or no services.**

   - **How is the FTC alerted to these cases?**

The FTC is alerted to these cases in a variety of ways, including consumer complaints; information from our partnerships with federal, state, and local law enforcement; and information from our own foreclosure rescue and loan modification advertising Surf and additional monitoring to identify businesses responsible for potentially deceptive ads for mortgage loan modification or foreclosure assistance services and to deter illegal conduct.

   - **Is the FTC relying solely on consumer reporting and SARs?**

As discussed above, the FTC is not relying solely on consumer reporting and Suspicious Activity Reports. Consumer complaints are a vital – but not sole – source of information used by the Commission in assessing law enforcement targets. In addition, foreclosure rescue and loan modification schemes are not one of the top categories of consumer complaints the FTC receives perhaps because consumers may be more likely to complain to state and local authorities. Complaints generally are on the rise and reflect that advertising for mortgage relief has increased substantially. In the last year, the Commission received just over 2,400 complaints mentioning foreclosure, and again most of these were not necessarily foreclosure rescue scams.

Suspicious Activity Reports are forms that certain financial institutions must file under certain circumstances, such as when they know or suspect that funds come from illegal activity or disguise funds from illegal activity. The Commission staff does routinely seek financial information regarding its law enforcement targets, but it is not typical that the investigation yields Suspicious Activity Reports. When the staff does obtain Suspicious Activity Report information, it is just one piece of the information that the Commission uses to assess a target's practices.

8. **We have heard the deceptive radio ads of Federal Loan Modification Law Center. The FTC recently brought a suit against this company and restricted its advertising. What is the current status of the FTC's case against Federal Loan Modification Law Center?**

The current status is that the case continues in litigation. As you know, on April 24, at the FTC's request, a U.S. District Court issued a preliminary injunction enjoining FedMod's alleged unlawful conduct. That preliminary injunction prohibits the company from making the false and misleading representations about their purported mortgage loan modification services that prompted the lawsuit and requires that the company disclose that it is in no way affiliated with the U.S. Government or any government program. Additionally, this preliminary injunction bans the company from charging advance fees to consumers, which will also substantially limit the company's ability to cause irreparable injury to these vulnerable borrowers.

Ultimately, the agency is seeking through this litigation to secure a permanent injunction prohibiting the challenged practices and providing redress for consumers harmed by the company.

9. In what way should the compensation to loan modification specialists or foreclosure consultants be restricted? In your opinion, how should a company be allowed to reasonably charge for these services?

Based on the FTC's law enforcement, I believe advance fees raise concerns because, in those cases, the facts have shown that, after consumers pay the fee, the companies do little or nothing to help consumers as promised. The Commission has sought public comment on these and other issues in an ANPR announced on May 29, 2009. (See Questions 4, above, for more details about the ANPR.) Therefore, the Commission is considering these issues as part of that rulemaking.

10. In your opinion, are certain groups (i.e. low-income persons, minorities, the elderly, etc.) more likely to be targeted for foreclosure rescue fraud? To what extent have you seen foreclosure consultants targeting neighborhoods with high foreclosure rates?

Given the magnitude of the current economic crisis, my sense is that a wide cross-section of consumers in the United States has been affected by the foreclosure crisis. Nevertheless, it does seem likely that certain groups in the areas hardest hit with high foreclosure rates are the most likely targets for this type of fraud.

11. We know that most of these companies do little or no work for the homeowner. However, there are some legitimate companies that may be the exception to this rule. Does the FTC know how many loan modification companies are currently operating in the United States? Is there any way to track the number of these companies?

The FTC does not know how many loan modification companies are currently operating in the United States. I am not aware of any way to track the number of these companies. The Commission anticipates learning more about these issues during our rulemaking process. (See Question 4, above, for more details about the ANPRs.)

12. **In their quarterly Mortgage Metrics Report, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) found that 41 percent of modified loans were seriously delinquent 8 months after modification and that 51 percent of modified loans that resulted in higher or unchanged payments were seriously delinquent after 6 months.**

    - **Given the need to give homeowners sustainable mortgages to prevent redefaults, has the FTC looked at the extent to which homeowners using the services of loan modification specialists or foreclosure consultants are more likely to redefault on their loans?**

The FTC's efforts have been focusing on the segment of the loan modification and foreclosure consultant marketplace that is trying to prey on consumers through fraud and deception. In many cases, the consumer rarely, if ever, receives the loan modification that was promised, so the consumer is still trying to avoid the foreclosure and obtain the loan modification. Thus, with the bad actors on which the FTC focuses, re-default is not an issue.

13. **In your testimony you state that several national mortgage companies will be sending FTC consumer information directly to homeowners. In addition to providing this type of information, how else can we inform homeowners about the dangers of these scams?**

Prevention is the key with this type of frauds, particularly given the magnitude of the crisis and the harms that consumers suffer when they pay large up-front fees or sign over the titles to their homes to deceptive marketers of mortgage relief. Thus, any direct-to-consumer outreach efforts are essential. The Commission has conducted extensive consumer outreach, as discussed in Question 3, above. To the extent that you would like to inform homeowners about the dangers of these scams – such as constituent outreach events, direct mailings, and television or radio PSAs – the Commission would be delighted to work with you on those outreach efforts.

I again thank you for all of your work in this area.

Written Testimony of Florida Attorney General Bill McCollum before the House Financial Services Subcommittee on Housing and Community Opportunity

I have been asked to submit testimony today about the necessity for federal legislation to prevent foreclosure rescue fraud and loan modification scams. I have also been asked to comment on HR 1231. To put my testimony in context, it is necessary to provide to this Subcommittee background on how the State of Florida has dealt with the very pernicious problem of foreclosure rescue fraud and loan modification scams. In fact, Florida has been enforcing a state statute that is very similar to the proposed federal legislation since October 1, 2008.

Background:

For the past three years, Florida has consistently remained within the top three states leading the nation in the number of foreclosures filed. In January of 2009, Florida's 40,770 properties receiving foreclosure filings were the second highest total of any state. In addition, two Florida cities posted foreclosure rates in January among the top 10 metro foreclosure rates: Cape Coral-Fort Myers at No. 3, with one in every 80 housing units receiving a foreclosure filing and Port St. Lucie at No. 9 with one in every 123 housing units receiving a foreclosure filing. According to RealtyTrac, Florida's first quarter 2009 foreclosure filings were the second highest in the nation. Foreclosure filings were reported on 119,220 Florida properties, a 36 percent increase from the first quarter of 2008. The state posted the nation's fourth highest state foreclosure rate during the quarter, with one in every 73 housing units receiving a foreclosure filing.

Not surprisingly, foreclosure rescue businesses located within the state have been on the rise as well. Florida consumers are bombarded in every medium with advertisements for foreclosure rescue services. Many of these businesses are recent start ups that may have little or no relevant experience. Time and again homeowners are lured into contracts with these entities requiring hefty upfront payments with false promises of guaranteed success to avoid foreclosure and to resolve the matter with affordable results. More often than not, these contracts result in the homeowner losing the money and obtaining no relief to the imminent foreclosure.

My Office's Statewide Initiative To Combat Abusive Practices In The Housing Industry

In 2007, I initiated a statewide task force within my office to allow for better internal coordination between units and to better coordinate with other enforcement authorities tackling issues of mortgage and foreclosure rescue fraud. My initiative had three components: legislative changes; enforcement and litigation; and consumer and industry education.

Legislation

In years prior, the state's primary enforcement tool was the state's Deceptive and Unfair Trade Practices act. However, in 2008 the legislature enacted a new provision, presented in large

part by my office in conjunction with other parties, to specifically address foreclosure rescue businesses and their potentially abusive practices.

Effective October 1, 2008, foreclosure rescue entities that operate within Florida or solicit Florida residents must comply with the requirements and restrictions defined in Section 501.1377, Florida Statutes. Section 501.1377 addresses potential abuses by both foreclosure rescue consultants, who promise to assist a homeowner with negotiating more favorable payment terms or a loan modification, and foreclosure rescue transactions, which involve a conveyance of the distressed property to a third party in an attempt to avoid foreclosure and to retain for the homeowner an equitable or legal interest in the property.

A. Foreclosure Rescue Consultants:

The legislation affords homeowners certain key protections against abusive "rescue" practices. First, the law prohibits the consultant from collecting a fee from the homeowner in advance prior to completing all services contained in the contract. Second, a written contract must be executed by both parties before the consultant can initiate services. The contract must contain specific terms and conditions, a specific notice of the homeowner's right to cancel, an alert to contact the lender before signing the agreement, and other disclosures.

B. Foreclosure Rescue Transactions

In addition to the rescue consulting businesses, equity skimming-related scams threaten vulnerable consumers who are facing foreclosure. These "rescue" scams seek to siphon off the homeowner's equity in the home by promising to obtain refinancing or to take title to the home and rent it back to the homeowner until his/her financial situation improves. Section 501.1377 protects against these scams by setting forth specific requirements for a written contract with the homeowner before execution of any instrument that conveys an interest in the home and for any contract or agreement with the homeowner providing a right to repurchase the home, including a requirement that the purchase price to be charged to the homeowner for repurchase is not unconscionable, unfair, or commercially unreasonable. The law also requires that the purchaser assume or discharge any existing liens on the home.

Enforcement of Florida's Restrictions Regarding Foreclosure Rescue Consultants

Within the last year, my office has investigated over 200 foreclosure rescue businesses. Currently we have approximately 50 active investigations, including 8 cases in which lawsuits have been filed and more filings are imminent. We are also reviewing approximately 100 companies for potential violations and the numbers are growing each day.

A. Settlements:

A handful of foreclosure rescue investigations relating to compliance with the new legislation already have been resolved by assurances of voluntary compliance executed by the businesses, currently, the office is in settlement discussions with approximately 25 to 30 other

businesses being investigated for compliance with Section 501.1377. The terms of the existing settlements include 1) ceasing all noncompliant business operations, other than that required to complete a consumer's contract; 2) immediate refunds to consumers of illegal advance fees, or a timeframe in which the mitigation work must be completed, if significant mitigation is underway; and 3) payment of attorneys' fees and costs.

B. Litigation

The businesses and individuals against which litigation has been filed include: 1) Law and Associates and Thomas A. Law of Pinellas County, Florida; 2) Winberg, Lopez & Rodriguez Co. of Orlando, Winter Garden, and St. Petersburg, FL; 3) FMA Servicing Inc. a/k/a Financial Management Advisors a/k/a www.fmafinancial.com and Financial Management Services of Orlando Florida; and 4) Outreach Housing, LLC, United Home Front, LLC, Blair L. Wright, and Bryan E. Berry of Fort Lauderdale.

In February 2009, my office obtained a temporary injunction against FMA servicing which was charging consumers an upfront fee of $2500 for foreclosure rescue services and failed to provide a contract that compiled with Florida law. The offensive business practices have halted pursuant to the court's order and the office is pursuing permanent relief against this company.

In November of 2008, my office obtained a temporary injunction against Outreach Housing, LLC, United Home Front, LLC, Blair L. Wright, and Bryan E. Berry of Fort Lauderdale which was operating a foreclosure rescue business. The defendants allegedly represented to Florida homeowners that they should not make payments to their mortgage lenders as due, but should instead pay Outreach Housing approximately 60 percent of the monthly payments due to their lenders. In return for these monthly payments, the company and its owners allegedly claimed they would work with the lenders to reduce the consumers' mortgage debts. According to consumers' complaints, these services were not provided. The Florida Department of Financial Regulation also filed a lawsuit in February, 2009 against this business and a receiver was appointed pursuant to that lawsuit. The business is no longer operating and the office is still actively pursuing its litigation against the principals of the business. The Outreach Housing case was the subject of a CBS Nightly News broadcast on February 12, 2009 and the story can be seen at http://www.cbsnews.com/video/watch/?id=4798762n.

Enforcement of Florida's Laws Regarding Foreclosure Rescue Transactions:

My Mortgage Fraud Task Force has actively investigated and litigated a number of cases against foreclosure rescue businesses preying upon homeowners facing foreclosure.

A. Litigation

For example, in January 2008, my office sued National Foreclosure Management, Inc. and eighteen other defendants for their roles in an elaborate mortgage rescue scheme that allegedly defrauded at least 80 homeowners out of approximately $1.7 million in home equity.

A mortgage broker, operating his own mortgage brokerage allegedly targeted homeowners in the foreclosure process that had substantial equity in their homes and persuaded them to convey the titles to their homes to his company. Once the company had obtained the title to the homes, the company would strip the equity from the homes by refinancing them at inflated prices and by assessing fraudulent fees and costs, leaving little or nothing for the homeowner to recoup. The homes would then be sold outright to investors or straw buyers who would lease the homes back to the homeowners at a rental rate far exceeding the original mortgage payments, virtually ensuring the homeowners' eventual eviction. According to the lawsuit, the homeowners would end up with neither the titles to the homes nor the equity that rightfully belonged to them.

In March of 2008 my office sued Florida Housing Council, LLP and related corporations as well as their owners as the participants in an operation that allegedly defrauded hundreds of thousands of dollars in home equity from at least 38 homeowners in the foreclosure process. Representatives of the companies persuaded homeowners to sign documents, including complicated trust agreements and deeds, which conveyed the titles to their properties to trusts controlled by Florida Housing Council. The complaint states consumers were often charged various fees for signing the trust agreements even though no actual services were provided. According to the lawsuit, the defendants also occasionally misrepresented to consumers that Florida Housing Council was a government entity. Once the deeds were transferred, Florida Housing Council would allegedly charge the homeowners rent, and if rent was not paid, the homeowners would be evicted from their homes. The company's owner would supposedly either keep the homes or sell them for a profit.

In October of 2008, my office sued an individual for his alleged role in a foreclosure rescue scheme that targeted an elderly Palm Beach County resident. The lawsuit alleges that the defendant made misstatements on his mortgage loan application used to fund his purchase of the home and caused the victim to pay unnecessary additional fees and incur a significantly higher mortgage amount in order to prevent foreclosure.

In February of 2009, my office obtained a court order temporarily prohibiting an Orlando loan modification company from charging up-front fees to homeowners for loan modification services. According to the order issued by the Orange County Circuit Court, FMA Servicing, Inc. was barred from charging homeowners any fee in advance of providing loan modification services. FMA Servicing must comply with written notice requirements contained in the Foreclosure Rescue Fraud Prevention Act.

In March, 2009, my office filed a lawsuit against Lincoln Lending Services, LLC alleging foreclosure rescue fraud. Specifically, Lincoln Lending allegedly targeted Hispanics facing foreclosure and charged upfront fees for loan modification services in violation of Fla. Sta. § 501.1377. Lincoln Lending attempted to avoid the prohibition against upfront fees by charging consumers $2,700 for "forensic analysis" services. In addition, it was alleged that Lincoln Lending offered legal services, which would constitute the unauthorized practice of law in violation of Fla. Stat. § 877.02(1). My office obtained a temporary injunction against Lincoln Lending prohibiting it from engaging in any type of consumer debt related service or mortgage modification service and from taking payment from consumers for such services until further order of the court. In addition, the temporary injunction freezes the assets of Lincoln Lending

and requires Lincoln Lending to refund all upfront payments made by consumers for foreclosure rescue services after October 1, 2008.

Also in March of 2009, my office obtained an injunction against a South Florida loan modification company and its owner to freeze the company's assets until a lawsuit filed against the company could be heard in court. Miami-based Mortgage Crisis Solutions Association, LLC and owner Donald Gillette were accused of charging homeowners in foreclosure up-front fees as high as $2,995 for loan modification services, but never providing the services. Additionally, the lawsuit alleges Gillette and his company improperly advertised legal services and counsel. One of the victims stated Gillette and his company failed to provide her with representation at a foreclosure hearing and a foreclosure sale and advised her to file for bankruptcy without reason. The woman paid Gillette nearly $13,000 but was denied a refund.

Several criminal investigations have emanated from the litigation described above.

B. Consumer Education/Public and Industry Outreach/Interagency Efforts

To enhance consumer understanding and awareness of the statutory requirements and the potential illegal practices of foreclosure rescue entities, my office has issued numerous consumer alerts and has posted on our website consumer tips on how to avoid foreclosure rescue scams. We have also provided links to sites for government and nonprofit assistance with mortgage-related questions, including information regarding the new Homeowner Affordability and Stability Plan. Our office has participated with local municipalities, state agencies, and law enforcement in numerous consumer outreach efforts across the state including events in Winter Garden, Orlando, Altamonte Springs, Punta Gorda, Tampa and Cape Coral.

Attorneys in my office have also participated in industry education efforts including a presentation in September, 2008 to the Florida Housing Coalition regarding foreclosure rescue scams and have taught courses on mortgage fraud-related issues for the Florida Bar, the National College of District Attorneys, Florida Association of Mortgage Brokers, Florida State University College of Law and the Florida State University Real Estate Society. They have also participated in various media presentations on local television news programs, local radio and the CBS Evening News.

Additionally, members of my internal Mortgage Fraud Task Force continue to participate in various local interagency task forces and working groups around the state, including joint agency enforcement working groups comprised of state and federal law enforcement and multistate working groups. Certain of these groups coordinate enforcement efforts relating to specific targets and other working groups focus on legislative issues and formulating interagency positions on issues that relate to the housing crisis.

Establishment of the New Mortgage Fraud Website

My office also recently unveiled a new mortgage fraud website to educate consumers about the mortgage fraud scams in Florida. The new website (www.myfloridalegal.com/mortgagefraud) is linked to our main website and provides tips for

consumers to avoid becoming victims of mortgage fraud scam artists. It also provides consumers with information about how to report complaints of mortgage fraud to our Office. In addition, it provides answers to frequently asked questions about mortgage fraud, discusses the new law, Fla. Stat. § 501.1377, provides information about the companies under investigation by our Office as well as links to recent press releases involving mortgage fraud cases and issues. Finally, the mortgage fraud website also links to other helpful websites that can further educate them about their options. An informed consumer is much less likely to fall victim to a mortgage fraud con artist.

The Interagency Mortgage Fraud Task Force

Recognizing the severity of the mortgage fraud problem and the need for a comprehensive approach to combat mortgage fraud, I recently developed an Inter-Agency Mortgage Fraud Task Force to address ways different state agencies can work together to fight mortgage fraud. By establishing a team approach, we can bring "all hands on deck" to address one of the most pernicious effects on our economy we have seen in some time. The new task force is comprised of representatives from the Office of Financial Regulation; the Division of Real Estate of the Division of Business and Professional Responsibility; the Miami-Dade Mortgage Fraud Task Force; the Florida Department of Law Enforcement; The Florida Bar; the Florida Prosecuting Attorneys Association; the Florida Sheriffs Association; the Division of Insurance Fraud of the Department of Financial Services; the Florida Police Chiefs Association; and members of our Office. Specifically, the new task force will share information regarding jurisdiction of each agency and develop a method for informing other agencies when mortgage fraud cases may involve their jurisdiction. Members of the new task force will work together on mortgage fraud cases, where appropriate. In addition, the new task force will work together to educate Floridians regarding which agencies to contact to make a mortgage fraud-related complaint, depending on the type of complaint.

HR 1231

As I noted earlier, HR 1231 is quite similar to Florida Statute 501.1377 that passed our legislature last year and has been in effect since October 1, 2008. HR 1231 does not contain provisions, however, that pertain to foreclosure rescue scams that skim equity from consumers facing foreclosure, although, since equity in homes has largely disappeared, this type of provision is much less important now.

It has been our experience that prohibiting the charging of up-front fees is an effective method of eliminating or at least slowing down loan modification scam artists. Consequently, making a similar form of enforcement available on a nationwide basis and available in states and to states that do not have similar state laws can only be beneficial. In states that have legislation similar to ours, the bill provides an alternate forum in federal court to pursue violations. And, of course, the bill allows for federal participation in the attempt to eliminate this problem without preempting state enforcement of their own statutes or the federal statute.

Thank you for allowing me to submit this written testimony. Working together, we can make significant progress in eliminating foreclosure rescue scams.

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