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Loan Modification Companies – A New Boom Industry

Like daisies springing up after a rain storm, **loan modification companies (LMCs) are popping up throughout the country in the wake of the mortgage default crisis** – willing, but mostly not ready, to assist borrowers in need of modification services. Readiness should mean only one thing: functioning within a regulatory framework and the implementation of all relevant compliance requirements. However, **specific guidelines, rules, and statutes to regulate LMCs are either insufficient or non-existent in many states!**

Often, these companies are former mortgage brokers and real estate brokers who have recast themselves as experts in loan modifications. Armed with their database of previous loan originations, whether purchase money or refinance mortgages, LMCs now contact their former borrowers to pitch them this time around in two ways: either they offer to refinance the borrower into a lower interest rate mortgage, perhaps also into a different loan product, or, finding out that the borrower is in default of the existing loan terms, they offer to provide loan modification assistance. Another way they obtain a borrower's contact information includes perusing public notices, such as pending litigation vis-à-vis the recordation of a lis pendens.

Because we are a risk management firm devoted to the mortgage and lending industries, we often see firsthand the sometimes catastrophic results of not implementing an adequate compliance program.

Nothing cries out for regulatory compliance like the loan modification company!

In response to the need for regulatory compliance, our company developed a **comprehensive program, consisting of eight essential elements**, to evaluate an LMC's, a servicer's, or an attorney's processes and procedures with respect to loan modifications and loss mitigation.

For the 8 ACTION POINTS, see below.

LMCs relationship with Servicers

In an effort to deal directly with the borrower, **many servicers** have staffed-up. Although overwhelmed, **they must also contend with LMCs that may be unlicensed and unregulated. Servicers are subject to licensing and are highly regulated, so it is incumbent on them to know that an LMC is acting within the law** and has a dependable compliance program. Therefore, a servicer is often wary of the information and documentation it has received from an LMC, especially if the LMC cannot provide or prove its implementation of all state and federal regulatory requirements.

LMC and One State's Response

A typical complaint about LMCs concerns the charging of high upfront fees – regardless of services rendered. Several states now have implemented procedures to prevent this and certain other abuses. In fact, **collecting any upfront fee is inexcusable: if borrowers qualify for a loan modification under current investor, Agency, HUD, or Treasury guidelines, there is no commission involved – the actual charge to modify the loan is minimal.**

California has taken a lead in providing strong regulatory protection to the consumer interested in or needing loan modifications. The applicable California legislation is somewhat complex, but a brief working description can elucidate the kinds of measures one state is now undertaking.

So, let's take a rather brief look at **California's initiatives.**

In California, loan modifications are handled lawfully only by attorneys or real estate brokers licensed by the Department of Real Estate. These licensed real estate brokers are permitted to accept an advance fee only if an Advance Fee Agreement has been approved by the Department; however, to date, only a small number of these fee agreements have actually received such approval. In any event, **under the California Foreclosure Consultants Act it is against the law in California for Real Estate Brokers to accept an advance fee if a Notice of Default (NOD) has been filed. Only lawyers are able to collect an advance fee from clients after the recordation of the NOD, under California law.** Furthermore, California requires licensing for employees of LMCs in order to have contact with the public or present to Servicers regarding loan modifications.

In some instances in other states, attorneys may have worked with LMCs to farm and further develop these contact parameters, receiving referrals for the legal work thereby obtained and then compensating the LMCs for non-legal processing. Taking note of this ruse, the California DRE has advised in its [Spring 2009 Real Estate Bulletin](#), that “some lawyers are collecting advance fees (or retainer fees) and offering to employ real estate brokers and/or salespersons to supervise the real estate licensees as legal assistants, paralegals, or some other sort of legal office

personnel. Some lawyers are placing themselves as ‘in-house’ counsel in real estate companies and having advance/retainer fees paid to them as counsel. Such relationships and scenarios raise serious ethical and legal questions, for both the lawyers and the real estate licensees.”

Obviously, the absence of payment from the attorney for the LMC’s de facto marketing efforts is just one reason why an LMC seeks an advance fee. However, in [California the State Bar’s Committee on Professional Responsibility and Conduct](#) has gone so far as to issue an **Ethics Alert, reminding attorneys that a lawyer may not pay a referral or marketing fee to, or split attorney fees with, a “foreclosure consultant” or other person for referring distressed homeowners to the lawyer.** Violations of the Rules of Professional Conduct would also include entering into a joint venture with an LMC, approving loan modification documents, and acting as a general counsel to the LMC in order to provide legal advice to homeowners.

Nevertheless, the legislation affecting foreclosure and loan modification seems not to have dissuaded some LMCs and attorneys from pursuing questionable practices. Consequently, the State Bar of California, the [California Attorney General](#), and the Department of Real Estate are currently conducting vigorous investigations in an effort to uncover criminal and unlawful civil activities.

An LMC can be viewed as a marketing company, in some states unlicensed (and, therefore, effectively unregulated) that approaches distressed mortgagors and ramps them up to local attorneys to handle loan modifications. Using attorneys may give an air of legitimacy to a loan modification company, though this can be somewhat misleading. Applying California’s statutory requirements as an example, an LMC is not exempt from having to be licensed merely by utilizing “in-house” counsel. Of course, an attorney may obtain clients under his or her own license; but, an LMC that uses its own “in-house” attorney on loan modifications is not exempt from licensing or providing an Advance Fee Agreement, if applicable.

Legislative Activity

California has been used here for illustrative purposes. Legislatures in many states are already enacting laws to regulate LMC activity. Some state banking departments require an LMC and its employees to be licensed as a mortgage broker. The **legislative consensus seems to be that any individual directly or indirectly involved in negotiating, originating, offering or attempting to negotiate or offer loan modifications for a commission should be licensed as a mortgage broker.** Many states, however, have yet to provide interpretive clarification of existing statutes and guidelines or specific legislation to regulate the LMC.

Certain state banking departments have issued special bulletins and memos to address the loan modifications issue. [North Carolina](#), for instance, just recently issued a memo to all licensees **emphasizing the prohibition against assisting a borrower in obtaining a loan modification for compensation or gain;** the only exception being for employees of licensed servicers and lenders involved in servicing loans on behalf of the owner of the loans. Any attempt to collect

advance fees is strictly prohibited in North Carolina. Indeed, the banking department memo warns its licensees in no uncertain terms that “if you are solicited by anyone that purports to engage in the loan modification business, we encourage you not to partner with these businesses, as you may find yourself committing a crime in this State.”

8 Elements to Effective LMC Compliance

[Lenders Compliance Group](#) has developed a **comprehensive review of loan modification processes and procedures, consisting of eight elements**. It can be applied to LMCs, servicers, and attorneys – or any entity involved in the various dimensions of loss mitigation.

We strongly recommend **proactive implementation** of our program, or one like it, as this approach will assure compliance with state-specific and federal requirements.

Our program consists of the following:

1. **Baseline Review:** Full review of current compliance program, organizational structure, regulatory risk, and enforcement strategies.

2. Use of Legal Counsel and Referrals Attorneys

A thorough, documented, due diligence review, includes continual oversight of in-state and out-of-state loan modification attorneys and referral of new attorneys.

3. Legal Analysis

A state-by-state, complete review of the statutory requirements followed by in-state and out-of-state legal counsel to effectuate loan modifications and loss mitigation.

4. Agents and Affiliates Compliance

Compliance requirements for all contact with the public and review of service level agreements to assure implementation of policies and procedures.

5. Policies and Procedures

Infrastructure, regulatory tolerances, legal process, procedures, and federal and state guidelines are determined, tested, and updated.

6. Training

Webinar or on-site sessions devoted to federal and state regulatory compliance guidelines, providing on-going implementation of the highest standards of conduct.

7. Quality Control

Random sampling, quality control review of loan modification files for each state in which loan modifications are arranged, including review of state disclosures, forms, and legal procedures.

8. Periodic Reviews

Compliance reviews, annually, quarterly, or monthly to assure that business is maintained in accordance with established policies, procedures, and existing state and federal regulations.

Click the image for the LMC Compliance Presentation.



Good and Not-So-Good LMCs

Some LMCs are operating within the law, licensed where required, and fully complying with all relevant federal and state regulations. It is the unregulated LMC that poses a substantial threat to the consumer. **A few LMCs have proactively implemented a thorough risk assessment review and compliance program. Most have not.**

When the regulators eventually call to conduct an examination and perform their oversight responsibilities, the loan modification companies that can prove their compliance with and enforcement of all state and federal regulations will be best positioned to avoid criminal and civil judicial proceedings.

Jonathan Foxx is the President and Managing Director of Lenders Compliance Group, a risk management firm specializing in all areas of mortgage and lending regulatory compliance.

Lenders Compliance Group is a risk management firm, providing professional guidance to financial institutions in all areas of mortgage compliance, including the following areas: CORE Compliance Matrix and Rating • Federal and State Mortgage Compliance • Loan Level Analytics • Risk Assessments • Legal and Regulatory Reviews • Licensing - State, Federal, and FHA • Mortgage Quality Control • HMDA / CRA • Due Diligence Audits • RESPA / TILA / All Regulatory Compliance Reviews • Loss Mitigation • Banking, HUD, and Regulatory Examinations. Website: www.lenderscompliancegroup.com
Phone: (516) 442-3456

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