



February 12, 2016

Bureau of Consumer Protection
Federal Trade Commission
600 Pennsylvania Ave. NW
Washington, DC 20580

Via: <http://www.regulations.gov>

Re: *Docket No. FTC-2015-0120, Holder Rule Review, FTC File No. P164800*

Comments in Response to the Federal Trade Commission's Request for Public Comment on Its Trade Regulation Rule Concerning Preservation of Consumers' Claims and Defenses (The Holder Rule)

The National Association of Consumer Advocates (NACA), a nonprofit association of attorneys and consumer advocates whose primary focus is the protection and representation of consumers, is pleased to submit comments in response to the Federal Trade Commission's (FTC) request for public comment on the Holder Rule. As part of NACA's mission to serve as a voice for its members and consumers in the ongoing struggle to curb unfair or abusive business practices that affect consumers, we urge the Commission to preserve the Holder Rule, to reiterate its key features and remedies available to consumers, and to consider our recommendations below to facilitate effective application of the rule.

Background

The FTC's 1976 rule concerning the Preservation of Consumers' Claims and Defenses (called the "Holder Rule") protects consumers in the marketplace from unscrupulous vendors by providing a valuable avenue for redress when sellers act badly. The Holder Rule is meant to preserve any claims the consumer may have against the seller and those claims will run to any holder of the credit contract, covering most consumer transactions, including auto sales and student loans. Consumer advocates have described the Holder Rule as the "FTC's most effective tool against fraud." It is now a widely recognized and accepted rule across the country.

In 2012, the FTC issued an advisory opinion on the Holder Rule affirming consumers' rights under the Holder Rule. The advisory opinion was a response to a letter from nonprofit organizations, including NACA that requested clarification on consumers' rights under the Holder Rule, particularly in light of recent court decisions that appeared to limit the Holder Rule's impact. On December 1, 2015, the FTC issued a request for public comment on the overall costs and benefits, and regulatory and economic impact of the Holder Rule as part of the agency's regular review of all its regulations and guides.

The Holder Rule Provides Mostly Benefits, and Little or No Costs

The remedies available under the Holder Rule have become an important deterrent to unfair and abusive practices, and fraud in the marketplace. Before, consumers could be obligated under a contract to pay for a fraudulent product or service without recourse. The Holder Rule provides remedies for

consumers and honest businesses against fraudulent sellers, by sharing responsibility for fulfilling the contract with lenders and assignees under the contract.

The Holder Rule helps to facilitate proper performance under contracts by sellers. Assignees and creditors are in a better position to monitor sellers' conduct and reliability. Consequently, it is reasonable for assignees and creditors to take on sellers' potential liability to consumers. The responsibility arising from the Holder Rule gives assignees and creditors the incentive to complete due diligence when working with sellers. It facilitates a self-regulating scheme in the marketplace that works if its benefits and obligations are properly applied. This market mechanism is beneficial not only for millions of consumers who buy and purchase products and services every day, but also for federal and state public enforcement officials, including the FTC, that cannot possibly monitor all of these transactions on their own.

The housing bubble in the last decade illustrates how the credit industry takes advantage of consumers in the absence of a Holder Rule. This is illustrated by the foreclosure crisis that developed in 2008 at the beginning of the Great Recession. Because the Holder Rule does not apply to residential mortgages, lenders were able to make millions of irresponsible and often fraudulent mortgage loans and to sell those loans to the securitization industry, while the originators retained no liability for their lending misconduct. The buyers of these defective loans did not care about abusive loan origination practices because the holder-in-due-course defenses protected them from abusive loan origination claims and defenses. If the Holder Rule had applied to real estate credit, the financial meltdown in the real estate finance markets may not have occurred.

Recognizing the abuses that arose out of the Holder Rule's exclusion from application to mortgage loans, the Uniform Law Commission recently issued its Uniform Home Foreclosure Procedures Act¹. In states which enact the UHFPA, Section 705 of the Act will essentially eliminate holder-in-due-course protections for buyers of mortgage loans for a period of six years following loan origination. Thus, the UHFPA would, in effect, apply the Holder Rule to residential mortgages during this six-year period. This example illustrates the need, not only for the preservation of the Holder Rule, but also the need for its expansion and clarification.

The Holder Rule has had no cost to consumers and only minimal cost to businesses. While the Holder Rule was under consideration, industry argued that the Holder Rule would cut off consumer access to credit, or that consumers would be forced to find credit independent of the seller. But the opposite has been the case. Seller originated or arranged financing is customary for most consumer transactions, and credit card use has also grown dramatically as a way to finance purchases.

The current Federal Reserve Statistical Release for Consumer Credit², which excludes real estate loans, shows outstanding consumer credit of \$3,546 billion dollars with steady growth over the past four years. The FRB's historical data³ for such consumer credit shows that since 1976, when the Holder Rule was adopted, consumer credit has grown from \$190 million to its current \$3,456 billion. Consequently, the Holder Rule has had no adverse effect on consumers' access to credit and instead it has served manage explosive growth.

Because the economic engine of our economy is credit, our economy is only as strong as the quality of our credit. The Holder Rule plays an important role in filtering out the fraud from this significant outstanding consumer credit. By creating secondary market liability for seller's wrongful conduct, the Holder Rule plays a vital role in decreasing the incentives for sellers and other actors to originate, buy and sell credit contracts embedded with fraud and unlawful business practices.

¹ Uniform Law Commission, Home Foreclosure Procedures Act, <http://bit.ly/1KfRurk>.

² Board of Governors of the Federal Reserve System, Consumer Credit, <http://1.usa.gov/1qg88DZ>.

³ Federal Reserve System, Consumer Credit, Historical Data, <http://1.usa.gov/1V9AjYK>.

Finally, the cost of compliance for business is minimal. While the Holder Rule makes holders and not consumers bear the burden of a seller's misconduct, it gives holders the incentive to monitor seller conduct and potentially deter their misconduct. Holders are also in the best position to recover damages from sellers. Otherwise, the cost of the Holder Rule, which includes a requirement to insert a notice in consumer contracts, is not overly burdensome.

Recommendations

Clarify and Publicly Defend Plain Meaning of the Holder Rule

Despite the fact that the Holder Rule's language is clear and unambiguous, certain parties and courts have misinterpreted the Rule, limiting its benefits to consumers. The FTC should reiterate aspects of the rule that have been subject to restrictions by some courts.

The FTC should vigorously defend the Holder Rule from arbitrary determinations of limitation on a consumer's affirmative recovery. It should reiterate that a consumer-debtor may cancel indebtedness as well as be entitled to an affirmative recovery under proper circumstances. It can make clear that the rule's cap on recovery applies to the amount collected from an assignee or creditor and does not apply to amounts collected from a seller. Recovery under the rule occurs against creditors and assignees rather than sellers. This will ensure that a consumer-plaintiff will be entitled to fair redress from the assignee or creditor for losses.

In 2012, NACA joined a letter, authored by the National Consumer Law Center, to the FTC requesting clarification on consumers' rights under the Holder Rule. In its 2012 letter, the FTC clarified⁴ that the Holder Rule does not limit a consumer's rights to an affirmative recovery only to circumstances where the consumer could rescind the transaction or where the goods or services were totally worthless. While the letter provides that the Rule is unambiguous and that the Rule's plain language should be applied, it also acknowledged that some courts have misinterpreted the Rule, taken it out of context and misapplied language from the Rule's statement of basis and purpose. The FTC should reiterate this finding in a public notice to further publicize the correct interpretation of the Rule.

The FTC should also restate various types of recovery available under the Holder Rule, including rescission, damages, and punitive damages. In addition, the FTC should clarify that the Holder Rule's cap on recovery does not apply to attorney fees that the holder incurs. Many state and federal consumer statutes include fee-shifting statutes to encourage settlement, make it economically feasible for consumers to bring small claims, and discourage businesses from using their superior legal resources to wear down consumers. All of these purposes would be thwarted if attorney fees and litigation costs were lumped in with the recovery on the merits and capped at the amount of the creditor's maximum liability under the Holder Rule.

Facilitate Development and Enforcement of the Holder Rule for the Current Marketplace

- The FTC must clarify that the Holder Rule does not preempt state consumer protection statutes governing cost recovery or fee-shifting remedies applicable in state court. Remedies provided under state consumer protection law should be in addition to, and not in lieu of, other remedies.
- In 1979, the FTC adopted and published for comment an amendment to the Holder Rule that would extend compliance responsibilities not just to sellers but to creditors, but it was ultimately withdrawn.⁵ The amendment would have made it an unfair or deceptive practice for a creditor to acquire a contract not in compliance with the Holder Rule or to originate such a contract. The FTC

⁴ FTC Advisory Opinion, 16 C.F.R. Part 433: Federal Trade Commission Trade Regulation Rule Concerning the Preservation of Consumers' Claims and Defenses (The Holder Rule), May 3, 2012, <http://1.usa.gov/1SmdlQd>.

⁵ 44 Fed. Reg. 65771 (Nov. 15, 1979).

should formalize adoption of the amendment.

- The FTC should clarify and list specific practices that would be considered violations under the Holder Rule. For example, the FTC can make clear that the following are all violations: a seller telling a consumer that it is not potentially liable for seller-related claims; a holder telling the consumer that he or she is required to continue paying even if the consumer has complaints with the seller; a holder disclaiming any responsibility for actions of the seller; a creditor that fails to include the Holder Rule notice in documents it drafts, such as for, consumer credit transactions.

- The FTC should increase its enforcement of the Holder Rule, and hold more businesses accountable for failing to include the notice in their consumer contract terms. Consumers need proper notice of their rights to protect them in their dealings with sellers, creditors and assignees. Further, the notice serves as a contract term that consumers can enforce in state courts. Failure to provide notice deprives consumers of these rights and remedies.

- The FTC should make clear that a holder cannot evade its responsibility under the Holder Rule by selling a consumer credit to a new holder or back to the seller. Many holders take the position that because they sold the credit contract they are no longer liable under the Holder Rule. Regardless of the number of payments a holder has received, the FTC should make clear that “once a holder, always a holder” is the proper implementation of the Rule. Otherwise, any holder would be given an incentive to abandon a credit contract wherever it can to avoid liability under the Rule. Then, when the consumer seeks relief under the Holder Rule, the consumer can be faced with an ever-changing cast of holders that make any resolution impossible. Furthermore, a holder may sell a credit contract for pennies on the dollar to a fly-by-night debt buyer and place the consumer in the exact position the Holder Rule is intended to eliminate.

- The Uniform Law Commission limited application of the elimination of holder-in-due-course protections to six-years as a compromise with financial industry advocates who opposed any elimination of HDC protections. The FTC is urged to consider whether the real estate mortgage exclusion of the Holder Rule should be eliminated in its entirety.

If you have any questions or would like to discuss the issues above, please contact Christine Hines at Christine@consumeradvocates.org or (202) 452-1989.