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Educational Materials

2010

ABI NORTHEAST CONSUMER FORUM
MORTGAGES, MORTGAGES, MORTGAGES

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Making Home Affordable Program

On March 4, 2009 President Obama announced a sweeping program to assist borrowers in avoiding foreclosure. The goal was to offer assistance to 7 to 9 million home owners who were facing foreclosure with a combination of initiatives. The Home Affordable Loan Modification Program (HAMP) provided loan modifications to reduce monthly payments using term extensions, interest rate and principal reductions. The Home Affordable Refinance Program (HARP) offered refinancing of existing mortgages, the investor of which was Freddie Mac and Fannie Mae for home owners who had a solid payment history (were current on their payments), whose loan to value ratio did not exceed 105% and had income sufficient to meet their new mortgage payments. In November, 2009, an initiative to assist homeowners to avoid foreclosure who were found to be either ineligible for HAMP or HARP, declined to participate or fell out of a HAMP modification was launched. This program entitled Home Affordable Foreclosure Alternatives (HAFA) allowed servicers to offer deeds in lieu or short sales for otherwise eligible HAMP loans.

The borrowers who were and are currently eligible for these programs must be 30 days (Freddie/Fannie) or 60 days (other investors) behind on their loan or in imminent default and occupy the 1-4 family home as their principal residence (which occupancy must be verified). The mortgage balance can not exceed $729,750, with higher limits for 2-4 family homes. The borrower's monthly payments must not in most cases exceed 31 % of their monthly income. The loan must have been originated on or before January 1, 2009, income must be substantiated by tax returns, pay stubs, etc. and only one HAMP modification was allowed.

Almost immediately it became clear that there would be some significant challenges to implementation. Not all borrowers had a loan that was HAMP eligible and FHA borrower were not able to avail themselves of the more favorable terms under the HAMP program. Second lien holders' refusal to cooperate and reduce payments made the programs unusable for many homeowners. Servicers had to quickly hire staff and create what amounted to a staff of loan underwriters to properly assess program eligibility and understaffing at servicers' shops created bottle necks in response time. Terms of pooling and servicing agreements made it difficult if not impossible for servicers to modify loans using HAMP guidelines without violating contract terms. Borrowers who verbally provided income figures to qualify for a trial modification found that they were unable to produce the necessary substantiation of income to obtain a permanent

modification or "went dark" and failed to communicate with servicers after qualifying for a trial modification. A borrower who filed bankruptcy in the course of participating in a trial modification could be deemed ineligible for further participation in the program as such was considered a change in circumstance. Borrowers who lost their job could not in some circumstances use their unemployment benefits to qualify. In many areas, Borrowers whose property values were in free fall during 2009 suddenly found their loan to value ratio was too high for the HARP program while other borrowers in this predicament made a business decision to decline a loan modification in favor of walking away from their home. Home owners who were current on their loan and could afford their payments were encouraged to default in the mistaken belief that they would automatically be approved for a loan modification to reduce their payments, an effective back door refinance of their loan.

The Treasury Department in consultation with a host of industry groups, Freddie Mac who performs the auditing function for the programs, HUD and Fannie Mae almost immediately began applying enhancements and changes to the programs as issues with implementation surfaced. The success of the program has been mixed. In recent testimony, before the House Financial Services Subcommittee on Housing and Community Opportunity, a representative of the U.S. Department of the Treasury noted, of the homeowners in trial modifications only 36% have transitioned to permanent modifications citing unemployment, delays in servicers ramp up, etc.

The following is a brief summary of the status of the Making Homes Affordable Programs.

HAMP

Servicers who accepted TARP funds must participate and all others who agree to the terms of the program agreement are required to attempt to modify all eligible loans under HAMP guidelines. If a PSA prevents the offering of a HAMP modification, a good faith attempt must be made to obtain permission to do so. Any loan that is eligible must be assessed using a net present value test which compares expected cash flow with or without the modification. Servicers use a waterfall approach to reduce the monthly payment to no more than 31 % of income by reducing the interest rate down to a floor of 2%, extending the term up to 40 years and finally forbearing principal. There are incentive payments to servicers and borrowers for successful completion of short term and long term goals. Servicers receive reimbursement of monthly payment reductions, $1000 for each loan modification and another $1000 after one year,etc. Borrowers who make their modification payments on time receive $1,000 in principal reduction each year for 5 years. In 2010, a number of enhancements and procedural changes were announced. These include:

- Servicer must make reasonable attempts in writing to solicit a borrower who is two or more payments down. Reasonable attempts are defined as 4 telephone calls during the prior 30 days, mailing two written notices, providing a toll free number,etc
- Referral to foreclosure only after solicitation has failed or borrower is deemed ineligible for HAMP.
- Certification to the foreclosing attorney that a borrower is not eligible for HAMP.
- Borrowers in active bankruptcy must be considered for HAMP .
- Acknowledgment of receipt of initial package within 10 days of receipt.

- Halt a foreclosure action upon acceptance by a borrower of a trial plan based on verified income.
- Halt the foreclosure sale if the request for a loan modification is received at last 7 business days before the sale provided the borrower has not failed a loan modification before, was not deemed ineligible, etc.
- Borrowers in a loan modification who file for bankruptcy can not be deemed ineligible solely because of the filing.
- Servicers must be flexible in working with borrower in bankruptcy including extending trial payments from 3 to 5 months,
- Servicers servicing loans of Ch 13 debtors who are making post petition trial payment may not object to confirmation of their plan based on the payments, move for relief, etc.
- Under certain circumstances and at the servicers' discretion, Ch. 13 debtors may obtain a waiver of the trial plan payments and go directly to a permanent plan.
- Reconsideration of borrowers who become eligible for HAMP after initial evaluation.
- Timelines to encourage investors whose contracts prohibit HAMP modifications to allow modifications.
- For unemployed borrowers, use of unemployment benefits, reduction of mortgage payments to affordable levels for 3 months and up to 6 months.
- Compare standard NPV and alternative NPV using principal write down incentives and if alternative NPV is higher, there is the option for the servicer to use that.

FHA- HAMP

In 2009, with the Helping Families Save their Home Act, HUD expanded the authority of FHA to modify loans. This program allowed servicers of FHA loans to offer borrowers in imminent default forbearance and most importantly HAMP compliant modifications. Imminent default is defined as the borrower who is current or less than 30 days down. The definition of hardship was also clarified .Four trial payments are required before eligible for a permanent modification.

HAFA

In 2009, Treasure announced the introduction of the Home Affordable Foreclosure Alternative Program. New enhancements to the program were effective April 5, 2010. The HAMP borrower eligibility requirements apply. These program features include:

- Servicers must consider borrowers for HAFA within 30 days if they are determined not eligible for a modification, or are delinquent on a HAMP modification or request a short sale.
- If a servicer determines a borrower is eligible for HAFA they must notify the borrower of the alternatives and provide them 14 days to respond.
- The servicer must determine the value of the property and assess the title and liens to determine feasibility.

- The servicer must make a prior determination of minimum acceptable net proceeds on short sales using a consistently applied standard to determine fair market value and prevailing closing costs
- Creation of agreements and forms to expedite the exchange of information about the terms of the proposed short sale.
- The short sale agreement with the borrower must outline the term of the agreement which must be a minimum of 120 days, require that a local real estate broker be used to list the property, include antiflipping provisions and identify the portion of the proceeds which can be used to payoff junior liens,etc.
- A deed in lieu must be offered pursuant to a written agreement, can be subject to conveying clear title, specify a vacate date and offer $3000 relocation assistance.
- Monthly payments during the pendency of a short sale or deed in lieu maybe required provided they don't exceed 31% of income
- Payoffs to junior lien holders can be the greater of 6% of the loan balance, plus incentive payments of up to $2,000 or $6,000.
  Servicers are paid an incentive of $1,500.

HARP

The HARP program has struggled to be effective for two basic reasons. The reasons were falling real estate values resulted in loan to value ratios well below the qualifying ratios for refinancing and second lien holders refused to subordinate or reduce their liens which together derailed the process.
In 2009 the following changes were instituted:

- Loan to value ratios were increased to 125%
- For participating lenders, second liens terms can be modified by reducing the interest rate to 1% on fully amortizing or 2% for interest only loans, extend the term to 40 years and if the principal on the first was deferred or forgiven, the same percentage of treatment must be used.

SELECTED ISSUES IN WRONGFUL FORECLOSURE

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The lending practices that precipitated the foreclosure crisis are well documented. The homeowners who were the victims of those practices are now looking for ways to keep their homes in the face of foreclosure. In this short paper, I will discuss two categories of recent cases: cases in which homeowners have challenged foreclosure because of the failure of their loan servicer to offer a modification under the Home Affordable Modification Program ("HAMP"), and two cases in which a judge in Suffolk County, New York, took a firm stand against mortgage lenders who behaved questionably after the homeowners defaulted on their loans.

I. HAMP MODIFICATION CASES

In March 2009, the Obama Administration introduced HAMP as part of a broader Financial Stability Plan. The goal of HAMP is to help as many as four million struggling homeowners avoid foreclosure by modifying their loan terms to an affordable level. A borrower is eligible for a loan modification if: 1) she is delinquent in payment on her loan or faces imminent default; 2) she occupies her home as her primary residence; 3) her mortgage was originated before January 1, 2009; and 4) the outstanding balance on the loan is less than or equal to $729,750. A servicer will take several steps to reduce the loan payments to an affordable level, which is defined as 35% of the homeowner's total pre-tax monthly income. In order, these steps are: 1) lower the interest rate to as low as 2%; 2) extend the loan term to 40 years; and 3) defer a portion of the principal until the loan is paid off.

As of the time of this writing, HAMP is benefitting only a fraction of the homeowners that it was designed to help. In the meantime, many homeowners who may be eligible for HAMP are facing foreclosure. In the past several months, homeowners who have not received HAMP modifications are using that fact to contest foreclosure. In this short paper, I survey those cases and discuss the various causes of action that homeowners have raised to contest their foreclosures.

1) **Fifth Amendment.** The plaintiffs in *Huxtable v. Geithner*, 2009 U.S. Dist. LEXIS 119418 (S.D. Cal. 12/23/09) alleged that their servicer's failure to grant them a mortgage loan modification violated their Fifth Amendment procedural due process rights. The exact claim is not clear in the opinion, but it appears that the plaintiffs

claimed that the government, through the loan servicer, deprived them of property without due process of law.

The Fifth Amendment applies only to governmental actions. Sometimes, however, it applies to private entities, like the servicer in this case, when there is a sufficiently close nexus between the government and the private entity that the action of the private entity can be treated as the action of the government. Courts have applied several different tests to determine whether a private party's actions can be attributed to the state. Under the "joint action" test, the court looks to two factors: 1) whether the state "has so far insinuated itself into a position of interdependence with the private entity that it must be recognized as a joint participant in the challenged activity (*Kirtley v. Rainey*, 326 F. 3d 1088, 1093 (9th Cir. 2003)); and whether the private party's actions are "inextricably intertwined" with the government's actions (*Brunette v. Humane Soc'y of Ventura County*, 294 F. 3d 1205, 1211 (9th Cir. 2002)). The plaintiffs pled that the joint action test rendered the servicers' behavior the behavior of the government because HAMP imposes affirmative duties on lenders because if an applicant meets the HAMP criteria, the lender must grant a modification (note: the owner of the loan must give permission to modify under HAMP). The plaintiffs also pled that the servicers were acting as the government's agents in executing HAMP.

The court denied the motion of defendant servicer to dismiss the case, finding that under the joint action test, the plaintiff stated a claim on which relief could be granted. While extensive government regulation of a private party is not sufficient to apply the Fifth Amendment to the private party, the court found that HAMP *might* involve more than government regulation.

2) **Borrower as Third-Party Beneficiary of the HAMP Servicer Participation Agreement.** There are several cases in which a homeowner contested foreclosure claiming that the servicer's failure to modify his loan constituted a breach of the HAMP Servicer Participation Agreement ("Agreement"). To prevail in these cases, the homeowner must successfully claim that he is a third-party beneficiary of the Agreement. In three recent cases, the courts have granted the servicers' motions to dismiss on the breach of contract/third-party beneficiary claim. *See Villa v. Wells Fargo Bank, N.A.*, 2010 U.S. Dist LEXIS 23741 (S.D. Cal. March 15, 2010); *Escobedo v. Countrywide Home Loans. Inc.*, 2009 U.S. Dist. LEXIS 117017 (S.D. Cal. Dec. 15, 2009); *Wells Fargo Bank v. Small*, Index. No. 8887/08, Feb. 16, 2010 (Sup. Ct. Queens Cty. N.Y.).

In *Villa*, the plaintiffs' home was sold at a foreclosure sale despite the fact that plaintiffs had contacted Wells Fargo to request a loan modification. The plaintiffs then sued to have the foreclosure sale set aside and for cancellation of the trustee's deed. They alleged in their complaint that the servicer was required under the Agreement to postpone the foreclosure sale pending evaluation of their loan modification application.

The court in cases denying the plaintiff's third-party beneficiary claim cite the general rule that only an intended beneficiary can sue on a contract, *Klamath Water Users Protective Ass'n v. Patterson*, 204 F.3d. 1206, 1211 (9th Cir. 2000). Under the Restatement (Second) of Contracts, a beneficiary of a promise is an intended beneficiary if "recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and . . . the circumstances indicate that the promise intends to give the beneficiary the benefit of the promised performance." RESTATEMENT (SECOND) OF CONTRACTS § 302. One way to ascertain whether a party is an intended beneficiary is to determine whether the third party would be "reasonable in relying on the promise as manifesting an intention to confer a right on him or her." *Klamath*, 204 F.3d at 1211. In both *Villa* and *Escobedo*, the court found that the homeowner was not an intended beneficiary of the Agreement because the Agreement does not *require* the servicers to modify all eligible loans. In addition, the court in *Villa* noted that the fact that four million borrowers could benefit from HAMP weighed against considering homeowners to be intended beneficiaries of the Agreement.

On the other hand, in *Reyes v. Saxon Mortgage Services, Inc.*, 2009 U.S. Dist. LEXIS 125235 (S.D. Cal. Nov. 5, 2009), the U.S. District Court for the Southern District of California (the same court that dismissed the claims in *Villa* and Escobedo) refused to dismiss the third-party beneficiary claim of a homeowner, finding that "arguably, one of the purposes of the [Agreement] is to assist homeowners, like Plaintiff, facing foreclosure."

3) **Cases in which homeowners held off foreclosure under undefined theories.** Some homeowners have successfully stayed foreclosure proceedings arguing that a servicer must consider the homeowner for a modification before foreclosing. The legal theories on which the homeowners relied is not clear in *BAC Home Loans Servicing, L.P. v. Bates*, Case No. CV2009 06 2801 (Ct. Comm. Pleas, Butler Co. Ohio, March 8, 2009) and *Deutsche Bank Nat'l Trust Co. v. Hass*, Case No. 2009-2627-AV (Cir. Ct., Macomb Cty., Mich. Sept. 30, 2009). Because the homeowner in *Bates* had not been considered for a HAMP modification, the court refused to grant summary

judgment of foreclosure to the servicer. The court seemed to deny summary judgment based on the goal of HAMP, which is to help troubled borrowers keep their homes.

The court in *Hass* appeared to find that the homeowner was a third-party beneficiary of the HAMP Servicer Agreement without explicitly saying so. *Hass* presents another interesting wrinkle, however. The foreclosure sale in *Hass* took place before HAMP became effective. In Michigan, however, borrowers have a post-foreclosure redemption period of six months to one year. HAMP became effective during that redemption period. The plaintiffs argued, therefore, that they remained eligible for loan modification even after their property had been sold at foreclosure. The court agreed, noting that Michigan had a shorter foreclosure period but longer redemption period than other states and that uniformity would be served by allowing homeowners to modify their loans during the redemption period. Like the court in *Bates*, the court in *Hass* stressed the policy of HAMP in making its decision.

All of these opinions came from the very early stages of the cases involved, either from a motion for summary judgment or a motion to dismiss. As HAMP continues, however, it is foreseeable that other cases involving the servicer's failure to modify a mortgage loan will make their way to the courts and these opinions will give some guidance to lawyers whose clients face foreclosure despite their attempts to obtain a HAMP modification.

II. ONE JUDGE'S ATTACK ON ABUSIVE LENDING PRACTICES

In two recent cases in New York, Suffolk County Supreme Court judge Jeffrey Spinner denied mortgage holders full relief because of their abusive post-default practices. In both cases, the mortgage holder had modified the loan after the homeowner's default, but the modification process was questionable at best.

1) ***IndyMac Bank, F.S.B. v. Yano-Horoski,* 890 N.Y.S. 2d 313 (Sup. Ct. Suffolk Cty. 2009).**

This case involves a homeowner who was not eligible for a HAMP modification.

New York has a law requiring a mandatory settlement conference in residential foreclosure actions. In this case, the plaintiff bank failed to cooperate in scheduling such a conference, resulting in five continuances. At the conference, the plaintiff claimed that the borrower owed over $525,000 and conceded that the home was worth no more than $275,000. The court found a plethora of bad behavior on the part of the bank. The bank sent the borrower a Forbearance Agreement only after its stated first payment due date. In addition, the bank rejected an offer by the borrower's daughter to purchase the home in a short sale, refused to consider a loan modification using no more than 25% of the income of the borrower's husband and daughter, and

refused to consider an offer by the borrower's husband and daughter to commit themselves personally for the full indebtedness.

The bank's misdeeds did not stop there. Although the bank claimed a loan balance in excess of $525,000, the court could find evidence of only $447,028.50 due. In addition, the court found that the bank overstated its escrow advance by over $34,000.

The court took the bold step of cancelling the note and the mortgage in this case, vacating the judgment of foreclosure and prohibiting the bank from collecting any sums due on the note in the future. In so ruling, the court relied heavily on the fact that a foreclosure proceeding sounds in equity. Because of the equitable maxim of "clean hands," a court will not grant equitable relief to a party who has acted in a manner that shocks the conscience of the court. The court found that the bank's post-foreclosure conduct towards the borrower was "inequitable, unconscionable, vexations and opprobrious."

2) ***Emigrant Mortgage Co., Inc. v. Corcione*, 2010 N.Y. Misc. LEXIS 777 (Sup. Ct. Suffolk Cty. Apr. 16, 2010).** The plaintiff bank in this case commenced foreclosure proceedings fourteen months after the defendant homeowner's default. The homeowner claimed that from the time of his payment default, he had tried to obtain a loan modification from the bank. Interest had accrued at the default rate during the fourteen month period, and by the time of the mandatory settlement conference, the interest owing on the loan was $95,154.65.

The bank finally produced a modification agreement at the foreclosure settlement conference. The court found the terms of the agreement to be reprehensible. Among the agreement's terms were: a waiver (on the part of the homeowner) of all claims, counterclaims, and defenses with respect to the indebtedness, an acknowledgment that no payments made under the agreement would constitute a waiver of the lender's right to foreclose, a clause denying the borrower a grace period for payment defaults and denying the borrower the right to cure any such default, and a waiver (on the part of the homeowner) of all Truth-in-Lending, deceptive trade practices, and consumer fraud claims. Most disturbing to the court was an "agreement" on the part of the borrower that if they filed for bankruptcy, they would consent to immediate relief from the automatic stay.

Judge Spinner again relied on the equitable nature of foreclosure proceedings to deny the mortgage lender relief. The court denied the lender's summary judgment motion for foreclosure. In addition, the court barred the bank from collecting any interest that accrued on the loan after the date of default and also barred the bank from collecting

all claimed legal fees and expenses. Last, the court imposed exemplary damages of $100,000.

These cases are interesting because they show how state courts are punishing abusive lending practices. Homeowners fare worse in bankruptcy, because they are unable to modify their loans in Chapter 13 regardless of the lender's behavior. Bankruptcy law respects state law contract and property rights, however, and if a claim is not enforceable under state law, it should not be enforceable in bankruptcy.

MORTGAGES, MORTGAGES, MORTGAGES PANEL SESSION
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Legal Developments and Trends

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A. CLAIMS FILED BY MORTGAGE CREDITORS

Because the debtor's main objective in many chapter 13 bankruptcy cases is to cure and reinstate a mortgage, minimizing the cost of reinstatement requires careful review of the creditor's proof of claim to prevent overcharges. Often problems relate to the way servicers apply payments in chapter 13 cases. The effect of a cure in a chapter 13 case is to nullify all consequences of the prebankruptcy default.[1] Once the debtor's chapter 13 plan is confirmed in a case involving a long-term mortgage, the debtor's ongoing regular mortgage payments should be applied from the petition date based on the mortgage contract terms and original loan amortization as if no default exists.[2] All prepetition arrearages are paid separately under the plan as a part of the mortgage servicer's allowed claim.[3]

Ignoring the effect of plan confirmation, some mortgage creditors treat timely postpetition payments as if they were late. This occurs because of the industry practice outside of bankruptcy of crediting payments received to the oldest outstanding installment due, and the failure of the servicing industry to develop an automated system to deal with the bifurcated payment application requirements of chapter 13 cases. Servicers often attempt to manually override their automated systems, but this cannot realistically be done without error for the three to five year duration of the plan.

These problems cause additional costs to be imposed on consumer debtors in the form of unauthorized fees. As payments are deemed late or insufficient, the automated servicer systems treat payments as unapplied and divert them to suspense accounts, impose late fees and additional interest charges, and order property inspections and other default related

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[1] *See* 11.6.2.8, *infra; see also* House Report to the Bankruptcy Reform Act of 1994, H.R. Rep. No. 835, 103d Cong., 2d Sess. 55 (1994) reprinted in 1994 U.S.C.C.A.N. 3340 ("It is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred.").
[2] *See* 11.6.2.8, *infra; In re* Wines, 239 B.R. 703 (Bankr. D.N.J. 1999); *In re* Rathe, 114 B.R. 253 (Bankr. D. Idaho 1990).
[3] Rake v. Wade, 508 U.S. 464, 473 (1993)(noting that as authorized by section 1322(b)(5), mortgage creditor's claim is effectively "split ... into two separate claims - the underlying debt and the arrearages").

services.[4] In addition, debtors are often not notified of interest rate adjustments on adjustable rate mortgages or payment changes on escrow accounts, leaving debtors who successfully complete their chapter 13 plans with bills for thousands of dollars of previously undisclosed improper fees when they emerge from bankruptcy.[5]

Informal discovery on the elements of a creditor's claim can be obtained under the Real Estate Settlement Procedures Act with potential sanctions for failure to provide timely information. If a borrower sends a "qualified written request" asserting the account is in error or asking a question about the account, a mortgage servicer must within sixty business days conduct an investigation if an error is alleged; provide the requested information; make any necessary corrections to the account; and inform the consumer of the actions taken.[6] Once an objection to claim or other action is filed, full discovery under the Federal Rules of Bankruptcy Procedure becomes available.[7] As the claim objection would raise issues about the extent of a lien and goes beyond issues of property valuation, it must be pursued as an adversary proceeding.[8]

Escrow overcharges

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[4] *E.g.*, Wells Fargo Bank v. Jones, 391 B.R. 577 (E.D. La. 2008) (mortgage creditor collected at closing on court-approved refinancing additional $24,450 in illegal postpetition fees and interest charges imposed during chapter 13 case).

[5] *E.g., In re* Dominique, 368 B.R. 913 (Bankr.S.D.Fla. 2007)(servicer failed to provide escrow statements during chapter 13 plan and just before plan completion provided debtors with an escrow account review indicating a $6,397 escrow deficiency); *In re* Rizzo-Cheverier, 364 B.R. 532 (Bankr.S.D.N.Y. 2007)(servicer allowed deficiency in escrow account to accrue and then, without notice to debtor, applied trustee plan payments intended for prepetition arrears to postpetition escrow deficiency).

[6] 12 U.S.C. § 2605(e)(1)(B)(2); 24 C.F.R. § 3500.21(e)(3); *see* National Consumer Law Center, Foreclosures §§ 8.2.2.4, 8.2.2.5 (2d ed. 2007 and Supp.).

The appropriate address for the qualified written request can usually be obtained from the website of the servicer or may be obtained by calling the servicer. Some mortgage holders and servicers claim that RESPA is not applicable when the borrower is in bankruptcy. Most courts have rejected this argument. *See* Conley v. Cent. Mortg. Co., 2009 WL 2498022 (E.D. Mich. Aug. 11, 2009); Chase Manhattan Mortgage Corp. v. Padgett, 268 B.R. 309 (S.D. Fla. 2001); *In re* Moffitt, 390 B.R. 368 (Bankr. E.D. Ark. 2008); *In re* Payne, 387 B.R. 614 (Bankr. D. Kan. 2008); *In re* Johnson, 384 B.R. 763 (Bankr. E.D. Mich. 2008); *In re* Laskowski, 384 B.R. 518 (Bankr. N.D. Ind. 2008); *In re* Figard, 382 B.R. 695 (Bankr. W.D. Pa. 2008); *In re* Padilla, 379 B.R. 643 (Bankr. S.D. Tex. 2007); *In re* Sánchez-Rodríguez, 377 B.R. 1 (Bankr. D. P.R. 2007); *In re* Holland, 374 B.R. 409 (Bankr. D. Mass. 2007). *See also* National Consumer Law Center, Foreclosures § 8.2.5.1 (2d ed. 2007 and Supp.).

[7] Federal Rules of Bankruptcy Procedure 7026/-/7037 as made applicable to contested matters by Federal Rule of Bankruptcy Procedure 9014.

[8] Fed. R. Bankr. P. 3007(b) and 7001; *see* § 13.2.4.1, *supra*.

One of the most common problems found in reviewing mortgage claims relates to the collection of escrow arrears.[9] Often, this occurs because servicers fail to consider the effect of a chapter 13 cure plan and use the total amount of escrow arrears in reevaluating the borrower's escrow account after the chapter 13 case is filed. This review of the escrow account is then used as the basis for calculating the debtor's new postpetition escrow payment going forward. However, in most cases prepetition escrow payment arrears have already been included in the bankruptcy proof of claim and are being paid through a chapter 13 plan. Because those arrears are being paid under the plan, this practice can lead to double or sometimes triple payment (when the escrow arrears are already double counted in the proof of claim).[10]

Mortgage servicers are required under the Real Estate Settlement Procedures Act to reevaluate each borrower's escrow account on an annual basis.[11] When a chapter 13 case is filed to cure a mortgage default, the servicer should conduct an escrow account analysis to determine the debtor's new escrow payment before the first postpetition payment is due.[12] The Real Estate Settlement Procedures Act permits the servicer to conduct such an analysis in this situation before the end of debtor's normal escrow account year.[13] Importantly, to give effect to the cure plan, the servicer must treat all unpaid prepetition escrow payments as if they have been paid in conducting this analysis. These unpaid prepetition escrow payments are part of mortgage holder's arrearage claim to be paid under the plan and cannot be collected in postpetition maintenance payments.[14] Thus, prepetition escrow account shortages and deficiencies, often representing amounts

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[9] Many first mortgage claims include required escrow payments for taxes and insurance. (In some states, consumer escrows associated with mortgage claims are called "impound accounts.") In situations in which modification of mortgage terms is allowed, it may be possible to cancel the escrow account in order to pay the holder only principal and interest. In that event, the debtor would usually have to pay taxes and insurance separately.

[10] *See In re* Pitts, 354 B.R. 58 (Bankr. E.D. Pa. 2006)(incongruity of proof of claim that seemed to claim taxes as a separate item as well as escrow deficiency satisfied debtor's burden of challenging validity of claim and mortgage company failed to meet burden of presenting evidence justifying taxes claimed).

[11] *See* 12 U.S.C. § 2609(c), National Consumer Law Center, Foreclosures § 8.3.2 (2d ed. 2007 and Supp.). *See also In re* Laskowski, 384 B.R. 518 (Bankr.N.D.Ind. 2008)(bankruptcy exemption in Regulation X relating to escrow statement does not relieve servicer of duty to conduct annual escrow analysis).

[12] Chapter 13 plan payments generally begin no later than 30 days after the case is filed. *See* 11 U.S.C. § 1326(a).

[13] RESPA's implementing regulation, Regulation X, provides that in certain situations the servicer need not wait until the end of the twelve-month escrow computation year to perform an escrow analysis. If the analysis is done before the end of the twelve-month computation year, the servicer is required to send the borrower a "short year statement" which will change one escrow account computation year to another, and establish the beginning date of the new computation year. *See* Reg. X, 24 C.F.R. § 3500.17(i)(4).

[14] Campbell v. Countrywide Home Loans, Inc., 545 F.3d 348 (5th Cir. 2008).

disbursed by the servicer for taxes, insurance and other escrow items when there were insufficient funds in the debtor's escrow account, are largely paid as part of the mortgage holder's arrearage claim during the longer cure period under the plan rather than recovered in the shorter one-year period following the case filing as part of debtor's escrow portion of the postpetition maintenance payments. If done correctly, in most cases this will produce a lower monthly escrow payment to be included as part of the debtor's total postpetition maintenance payments.

Escrow overcharges may also arise because fees and charges associated with foreclosure are broken out as separate elements of the arrears. At the same time, the servicer may have also included those fees and charges in the borrower's escrow account when they were paid out.[15] These fees are then double counted in the proof of claim: once as "foreclosure costs" and again as a portion of the amount denominated as "payment arrears."

Proofs of claim should be reviewed for these problems. When the line item for escrow arrears appears to be out of line, (for example, if it is more than the amount of the monthly payment for taxes and insurance multiplied by the number of months the debtor is in arrears), then more information should be requested, by discovery if necessary. At the same time, debtors should be told to be on the alert for unusual changes in their monthly payment amounts while the chapter 13 case is pending. Of equal concern, debtors should be told to notify their attorney if the servicer fails to provide annual escrow statements and payment change notices during the chapter 13 case.

Late charge and mistakes in crediting payments

Hidden late charges are only one of several problems with incorrect crediting of payments made to cure a default under a chapter 13 plan.[16] These problems may not be easily detectable without reviewing loan payment records.[17] At a minimum, when a debtor has cured a default, payment records should be reviewed at the close of the case to make sure that they reflect the cure. Careful drafting of the debtor's plan to specifically direct how payments are be applied, as discussed below, can provide a basis for challenging improper fees during and after the bankruptcy case.

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[15] Fees paid to third-party vendors who provide foreclosure services are often referred to as "corporate advances." Although these advances are not typically treated as an escrow item, servicers occasionally disburse funds from the borrower's escrow account to pay for these foreclosure expenses.

[16] *Debtors Force Mortgage Servicer to Remedy Chapter 13 Violations*, 12 NCLC REPORTS *Bankruptcy and Foreclosures Ed*. 43 (Mar./Apr. 1994).

[17] *See In re* Boday, 397 B.R. 846 (Bankr. N.D. Ohio 2008) (after reviewing payment records showing that plan payments had been misapplied, court ordered mortgage creditor to adjust its records to reflect amount owed based on original amortization schedule); *In re* Wines, 239 B.R. 703 (Bankr. D.N.J. 1999) (example of case reconciling payments made and proof of claim).

Proof of claim and bankruptcy monitoring fees

Mortgage creditors routinely charge a "proof of claim" or "bankruptcy" fee to consumer debtors in chapter 13 cases. A "proof of claim" or "bankruptcy" fee generally represents a charge for the initial set-up work of the law firm hired by the servicer when a chapter 13 is filed, review of the debtor's schedules and plan, and tasks related to the preparation and filing of a proof of claim.[18] It may also include monitoring the case until plan confirmation. Two large national mortgage creditors, for example, have agreements to pay a fixed fee to a law firm for such "Claim Services" in chapter 13 cases filed in Texas.[19]

These fees are incurred postpetition but prior to plan confirmation, and are generally treated as legal fees recoverable against the debtor and included as part of the amount needed to cure a mortgage default.[20] In response to a series of class action cases filed in the Southern District of Alabama in the late 1990s against numerous mortgage servicers for failing to disclose postpetition proof of claim fees,[21] most servicers now disclose that a fee is being charged, either by listing the fee on the proof of claim or by filing a separate Rule 2016 fee application.[22]

Proof of claim fees are currently charged in the range of $200 to $500, depending upon the extent to which services in addition to claim preparation are provided.[23] As with many fees charged to borrowers in consumer transactions, the amount on an individual basis is relatively small. Spread more widely, it can be estimated that chapter 13 debtors

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[18] *In re* Collins, 2009 WL 1607737 (Bankr.S.D.Tex. Jun 08, 2009).
[19] *In re* Rangel, 408 B.R. 650 (Bankr.S.D.Tex. 2009).
[20] Generally, if a debtor proposes to cure a default on a claim secured by the debtor's principal residence, the mortgage holder may recover both prepetition and postpetition attorneys' fees if they are reasonable, and permitted by the underlying mortgage documents and applicable nonbankruptcy law. *See* 11 U.S.C. §§ 506(b), 1322(b)(5) and 1322(e).
[21] *See, e.g.,* Dean v. First Union Mortgage Corporation, 281 B.R. 327 (Bankr. S.D. Ala. 2002); Noletto v. NationsBanc Mortgage Corp., 281 B.R. 36, 47 (Bankr.S.D.Ala. 2000); Harris v. First Union Mortgage Corp., 280 B.R. 876 (Bankr.S.D.Ala. 2001).
[22] One national law firm states on an attachment to the claim that "fees and costs have been incurred" for the filing of the proof of claim, but they are not included in the claim. Debtors are instructed to call the law firm if debtors "want these fees and costs included in the Proof of Claim so that the subject loan is current" upon plan completion.
[23] *E.g.*, *In re* Bartch, 2009 WL 3853215 (Bankr.M.D.N.C. Nov 16, 2009)($350 fee); *In re* Rangel, 408 B.R. 650 (Bankr.S.D.Tex. 2009)(involving four cases seeking $200-$250 fees for claim preparation and $150 for fee applications); *In re* Palmer, 386 B.R. 875 (Bankr.N.D.Fla. 2008)($500 fee).

filing plans to cure mortgage defaults were charged last year approximately $66 million in proof of claim fees.[24]

It was revealed in the Alabama class action cases that proof of claim fees have not always been charged to consumer debtors. In one the first cases to go to trial, *Slick v. Norwest Mortgage, Inc.,* the court found that the servicer initially prepared and filed proofs of claim using in-house staff, and that it did not charge borrowers a separate fee for this work.[25] All expenses incurred for preparing proofs of claim were borne by the servicer as general operating expenses in the same way that expenses are incurred by servicers for preparing escrow statements and payment notices.

Over the course of several years, however, this work was transferred by the servicer in *Slick* to various outside law firms and bankruptcy service companies. With the outsourcing of this work came the practice of charging debtors a fee for the preparation of proofs of claim. Evidence at trial also established that while the servicer initially disclosed these fees on proofs of claim, it later changed its policy in response to legal challenges that these fees were not authorized by the underlying mortgage documents if treated as an ordinary servicer cost of doing business.[26] This outsourcing of proof of claim preparation has now become commonplace in the mortgage industry.[27]

National mortgage servicers in recent years have relied upon "default service providers" (DSP) to assist with default processing functions. These firms offer a variety of products to servicers, such as electronic information technology products which transmit information from the servicer's payment systems to local counsel handling foreclosure actions and bankruptcy stay relief motions. DSPs that specialize in legal and litigation support often handle the preparation of routine foreclosure and bankruptcy documents,

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[24] This figure is based on filing statistics provided by the Administrative office of the U.S. Courts for the fiscal year ending September 20, 2009, and assuming an average $250 fee was charged in two-thirds of the cases filed.

[25] Slick v. Norwest Mortgage, Inc., Case No. 98-14378, Adv. No. 99-01136 (Bankr. S.D. Ala. May 10, 2002) (order awarding judgment to debtors including sanctions for non-disclosure of bankruptcy fees), available on the court's website at: http://www.alsb.uscourts.gov:8081/ISYSquery/IRL7A4E.tmp/4/doc.

[26] The *Slick* court suggested that the servicer changed its policy based upon litigation in Majchrowski v. Norwest Mortg., Inc., 6 F.Supp.2d 946 (N.D.Ill. 1998).

[27] The apparent purpose for charging proof of claim fees is to shift expenses from servicers to borrowers. For mortgages loans held by a securitized trust, servicers also benefit by being able to recover out-of-pocket expenses from investors under the terms of applicable pooling and servicing agreements, whereas they are not permitted to do so if the expense is part of the servicer's general overhead and labor costs. *See* Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, & Eileen Mauskopf, *The Incentives of Mortgage Servicers: Myths and Realities* 17 (Fed. Reserve Bd. Fin. & Econ. Discussion Series Div. Research & Statistical Affairs Working Paper No. 2008-46).

such as default notices and bankruptcy claims. They typically serve as the go-between for the foreclosing servicer and its local counsel who has entered an appearance on behalf of the servicer in the bankruptcy or state court. In some cases, even the selection of local counsel is delegated by the servicer to the DSP. For tasks done by large national DSPs providing legal support, it is often difficult to determine whether the service has been provided by a law firm or other non-attorney entities owned by the law firm or affiliated with it.[28]

The arrangements between servicers, legal support DSPs, and local counsel have been scrutinized in several recent cases. In *In re Parsley*,[29] a national law firm retained local counsel to represent the mortgage servicer in bankruptcy stay relief proceedings. The motion for relief filed by local counsel ultimately proved to have inaccuracies regarding the account arrears. Significantly, the national law firm's engagement letter with the local firm specifically prohibited any communication between local counsel and the servicer, who was the movant on the motion and the local counsel's client. In other words, the arrangement prohibited local counsel from communicating directly with its own client.[30]

It was also disclosed in *Parsley* that the national law firm had created a separate entity to provide "simplified" loan histories to local counsel for use in prosecuting stay relief motions. This new entity employed 300-350 legal assistants who prepare the histories based on the servicer's payment records. However, no attorney for the national law firm ever reviews the simplified histories for accuracy before they are provided to local counsel. Commenting on why mortgage servicers prefer this model, the court in *Parlsey* noted that their "attitude is that once it has referred the file to national counsel, it does not want to be bothered with any details about the pleadings and proceedings which follow."[31]

An initial question prompted by outsourcing is whether it is reasonable for mortgage servicers to retain counsel as a matter of course to perform the claim filing function in chapter 13 cases. Many courts have held that attorney involvement is appropriate and have allowed attorneys' fees for claim preparation services.[32] Some courts, however, have held that claim preparation is a ministerial act for which no attorneys' fees should

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[28] For example, the company history provided on the website for Prommis Solutions (formerly known MR Default Services, LLC) describes its relationship McCalla Raymer, LLC, and that of National Bankruptcy Services describes its relationship with Brice, Vander Linden & Wernick, P.C.

[29] 384 B.R. 138 (Bankr. S.D. Tex. 2008).

[30] Another court has described the role of local counsel in this arrangement as "dutiful scribes." *See In re* Stewart, 391 B.R. 327, 337 (Bankr.E.D.La. 2008), *aff'd In re* Stewart, 2009 WL 2448054 (E.D.La. Aug 07, 2009).

[31] *Taylor*, 384 B.R.at 163.

[32] *E.g., In re* Rangel, 408 B.R. 650, 666 (Bankr.S.D.Tex. 2009)(concluding that "paying an attorney" for claim preparation is reasonable); *In re* Moye, 385 B.R. 885, 891 (Bankr.S.D.Tex.2008); *In re* Powe, 278 B.R. 539 (Bankr.S.D.Ala. 2002).

be charged to the debtor.[33] In disallowing a proof of claim fee, one court noted that the "information contained in a proof of claim generally comes from a creditor's file and is not legal in nature to the extent attorney involvement is required," and that the "process generally requires filling in blanks on the form and attaching documentation."[34] Another court which has disallowed claim preparation fees has nevertheless held that a small fee may be permissible for services performed by a law firm to facilitate the filing of accurate proofs of claim by mortgage servicers.[35]

The more significant question based on the current use of DSP firms is whether postpetition proof of claim and bankruptcy fees are being proffered as representing legal fees when they are not. The recent case of *In re Taylor*[36] suggests that although proof of claim preparation has been outsourced to large national DSPs that appear to be law firms, the actual work may not be performed by paralegals or other legal professionals, and may not be done under the supervision of an attorney.

The Taylors' mortgage servicer operated a case management system widely used in the servicing industry which includes the mortgage service platform (MSP).[37] When a borrower files a chapter 13 bankruptcy, a program within MSP automatically refers the case to a national law firm based on the Default Services Agreement that the servicer has with the provider of MSP. The national law firm is the exclusive claims agent assigned to file proofs of claim for the servicer.

The *Taylor* court noted that proofs of claim are prepared at the national law firm by two sets of "clerks." One set of clerks is assigned to verify the debtors' social security numbers and loan numbers. The other set of clerks prepares the claim based on information contained on a program within MSP. According to the testimony in *Taylor*, these clerks "were not legally trained, i.e., paralegals, but were experienced in this task from having worked for mortgage companies."[38]

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[33] *In re* Madison, 337 B.R. 99, 105 (Bankr.N.D. Miss. 2006)(refusing to allow attorney fee for claim preparation or for "additional legal services such as file setup, attorney review of loan documents, or attorney review of bankruptcy plan as those services are unnecessary for preparation and filing of a proof of claim, which is basically a mathematical computation"); *In re* Allen, 215 B.R. 503 (Bankr.N.D.Tex. 1997); *In re* Thomas, 186 B.R. 470 (Bankr.W.D.Mo. 1995); *In re* Banks, 31 B.R. 173 (Bankr.N.D.Ala. 1982).

[34] *In re* Marks, 2005 WL 4799326, *2-3 (Bankr.W.D.La. Nov 30, 2005).

[35] *In re* Madison, 337 B.R. 99, 105 (Bankr.N.D. Miss. 2006).

[36] *In re* Taylor, 407 B.R. 618 (Bankr.E.D.Pa. 2009), *sanctions order rev'd by* 2010 WL 624909 (E.D. Pa. Feb 18, 2010)(setting aside bankruptcy court's findings of Rule 11 violations by specific local counsel, but noting concerns about wider LPS practices that were the subject of lengthy critical analysis by bankruptcy court).

[37] MSP is a product of Lender Processing Services, Inc., f/k/a Fidelity National Information Services, Inc.

[38] *See Taylor*, 407 B.R. 625, n. 13.

The proof of claim process at the national law firm as described in *Taylor* is overseen by a "Compliance Director," who is an attorney. The Compliance Director's signature is electronically affixed to each proof of claim. However, this attorney reviews only a random sample of 10% of the filed claims.[39] Despite the application of Bankruptcy Rule 9011, the evidence in *Taylor* suggests that 90% of the claims filed by the servicer are not prepared or reviewed by the attorney who signs them. None of the claims are reviewed by the servicer before they are filed. The actual proof of claim filed in the *Taylor* case listed an incorrect mortgage payment amount and attached an incorrect mortgage note.

Because the proof of claim in *Taylor* contained an attorney signature, the court had appropriately assumed that the conduct involved the practice of law and therefore imposed sanctions based on the attorney's professional misconduct. A recent case in Texas concerning an affiliate of the same national law firm involved in *Taylor* provides insight at to why courts and parties should not presume that claims filed by large national DSP firms involve the provision of legal services.

In *In re Crowder*, the court had issued an order to show cause why sanctions should not be imposed on the individual who had signed the proof of claim in the case, because he had failed to appear at a hearing concerning a proposed increase by the servicer in the debtor's mortgage payment. The court had apparently assumed the individual signing the claim was an attorney since the claim indicated that questions about fees related to the claim should be directed to the same law firm as in *Taylor*. A declaration filed in response, however, indicated that the individual signing the claim was not an attorney and that he actually worked for a limited liability partnership affiliated with the law firm which shares a similar name to the law firm.[40] The declaration further explained that there are several "non-legal functions" that the affiliate provides for servicers. With respect to borrowers in bankruptcy, the non-legal functions performed by the affiliate include "filing proofs of claims" and "initial reviews of bankruptcy plans." The declaration stated in conclusion that the law firm affiliate "did not provide legal services" to the servicer in the case and did not have an "attorney-client relationship with the servicer."

By adding an attorney signature or law firm name to the proof of claim, even though an attorney has not personally reviewed, prepared, or supervised the preparation of the claim, mortgage servicers and the law firms that participate in outsourcing systems may create the false impression that the fees charged to consumer debtors represent the provision of legal services. This practice may also lead parties involved to believe that that the fees are reasonable and recoverable against the borrower under the attorney fee shifting provisions of the mortgage documents, and are therefore impervious to legal

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[39] *Id.* at 626.

[40] *In re Crowder*, Case No. 06-36030-H4-13 (Bankr. S.D. Texas), filed June 8, 2009, Declaration of Stephanie Jeffries, Exhibit A to Moss Codilis' Response to Order To Show Cause.

challenge. As the case law reflects, and perhaps as a result of this practice, proof of claim and bankruptcy fees are routinely treated by bankruptcy courts as attorneys' fees.[41]

Even if a proof of claim or monitoring fee is a fee for legal services, it may not be authorized by the mortgage loan documents. The typical clause applies when the mortgage holder defends the mortgage in a case which purports to affect the property, the lien, or the holder's powers or rights, or in actions to enforce the holder's rights, or in actions to recover for damage to or destruction of the property. A borrower's chapter 13 bankruptcy, because of the anti-modification provision in section 1322(b)(2), does not affect the property or the lien and is not an action to enforce the holder's rights.[42] The standard reimbursement clause also provides that the borrower is required to pay all of the holder's costs and expenses of any such action *in which the lender appears*, including reasonable attorney fees. Monitoring to determine whether an appearance is necessary does not appear to be covered.

Some mortgages contain provisions for recovery of fees which refer to bankruptcy proceedings. For example, a common mortgage and deed of trust provision states that if "there is a legal proceeding that may significantly affect Lender's rights in the property (such as a proceeding in bankruptcy, ...), then Lender may do and pay whatever is reasonable or appropriate to protect the value of the Property and Lender's rights in the Property...." Because this language refers to "a proceeding *in* bankruptcy," it may be construed as applying only when an adversary proceeding within the bankruptcy case is filed against the holder rather than the filing of a bankruptcy case itself, and therefore would not generally permit recovery of monitoring and proof of claim fees.[43]

A mortgage provision relating to recovery of fees may be ambiguous. It is a basic principal of contract law that any ambiguity in a contract is construed against the drafter,

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[41] *See, e.g.*, *In re* Bartch, 2009 WL 3853215 (Bankr.M.D.N.C. Nov 16, 2009); *In re* Rangel, 408 B.R. 650 (Bankr.S.D.Tex. 2009); *In re* Allen, 215 B.R. 503 (Bankr.N.D.Tex. 1997); *In re* Thomas, 186 B.R. 470 (Bankr.W.D.Mo. 1995).

[42] *In re* Thomas, 186 B.R. 470 (Bankr. W.D. Mo. 1995).

Even if there is a default, and a case is brought under chapter 13, the bankruptcy arguably does not affect the holder's rights, if the Code protects the holder's claim from being modified under 11 U.S.C. § 1322(b)(2). *In re* Rangel, 408 B.R. 650 (Bankr.S.D.Tex. 2009)(chapter 13 case is not a proceeding that might substantially affect mortgage holder's security interest because § 1322(b)(2) preserves holder's rights); *In re* Romano, 174 B.R. 342 (Bankr. M.D. Fla. 1994).

[43] *In re* Rangel, 408 B.R. 650 (Bankr.S.D.Tex. 2009)(deed of trust language construed as applying to proceeding brought within bankruptcy case).

in this case the lender.[44] Equally importantly, courts have strictly construed contractual provisions providing for fees and costs.[45] Attorneys should review the language of the contract closely to determine whether it actually says what the lender claims that it says, and whether it is ambiguous.[46] State law may also limit the fees that can be collected.[47]

Several holders and servicers charge a flat rate monitoring or proof of claim fee to all borrowers in bankruptcy. This uniform charge is obviously not based on actual costs or expenses in "monitoring" the borrower's bankruptcy. Instead, it is an attempt to spread costs among all borrowers who file bankruptcy. Contract provisions providing for attorney fees are only enforceable "to the extent that it is shown that the creditor has been damaged by having to pay, or assume the payment of attorney fees or other collection expenses."[48] These provisions often allow the holder or servicer to recover only fees and costs that have been actually "disbursed" to a third party to protect the collateral or the holder's rights.[49] Similarly, if a holder or servicer is charging for other costs based on a contract provision, it should be required to justify the costs and show that they were actually incurred.[50]

In addition to being actually incurred by the holder, the fee must be reasonable and properly documented. If the holder or servicer cannot document the basis for a charge after a debtor's good faith request for it to do so through the formal claim objection

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[44] *In re* Stark, 242 B.R. 866 (Bankr. W.D.N.C. 1999) (bankruptcy monitoring fees disallowed as ambiguous mortgage contract construed against lender); *In re* Williams, 1998 WL 372656 (Bankr. N.D. Ohio June 10, 1998) (ambiguous contract term inadequate basis to support creditor's request for fees for motion for relief from stay).
[45] *See, e.g.*, *In re* Sublett 895 F.2d 1381 (11th Cir. 1990); First Brandon Nat'l Bank v. Kerwin-White, 109 B.R. 626 (D. Vt. 1990); *see also*; *In re* Romano, 174 B.R. 342 (Bankr. M.D. Fla. 1994) (interpreting loan note's ambiguous attorney fee provision against the lender/drafter); *cf. In re* Majchrowski, 6 F. Supp. 2d 946 (N.D. Ill. 1998) (standard form mortgage provision allows lender to charge a fee for filing proof of claim and is not ambiguous so as to require construction against the drafter).
[46] *See In re* Hatala, 295 B.R. 62 (Bankr. D.N.J. 2003) (mortgage provided for fees only in foreclosure and not for fees incurred after foreclosure judgment; fees limited to those permitted by state rules); *In re* Woodham, 174 B.R. 346 (Bankr. M.D. Fla. 1994) (analysis of provision which does not specifically provide for attorneys fees in bankruptcy).
[47] *In re* Ransom, 361 B.R. 895 (Bankr. D. Mont. 2007) (Montana law limited fees to lesser of 1% of amount due or $1000). *See* § 11.6.2.7.1, *supra*.
[48] *In re* Banks, 31 B.R. 173, 178 (Bankr. N.D. Ala. 1982) (citing Annotation, 17 A.L.R.2d 288 § 8, at 298 (1951)).
[49] *In re* Rangel, 408 B.R. 650, note 11 (Bankr.S.D.Tex. 2009)(proof of claim fee disallowed because servicer did not produce any evidence that fee was actually disbursed to law firm and fee application merely stated that it had been invoiced).
[50] *See* Korea First Bank v. Lee, 14 F. Supp. 2d 530 (S.D.N.Y. 1998) (lender can collect no more than it agreed to pay its counsel).

process, discovery or other informal means, the court should disallow the charge.[51] If the fee is for services that are unnecessary or not appropriate, then it is not reasonable.[52] In most circumstances it is not necessary for the holder to do anything to protect its interest in a bankruptcy case.[53] A holder can adequately monitor a case simply by making sure that it continues to receive payments (which is what the lender does in any event). The Bankruptcy Code and Rules expressly provide for notice if any action is taken which affects its mortgage.[54] A holder can rely on receiving those notices without any affirmative action to monitor the case.

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[51] *In re* Prevo, 394 B.R. 847 (Bankr. S.D. Tex. 2008)(foreclosure fees, BPO fees and late charges disallowed because the lender failed to submit documentation and comply with basic requirements of Official Form 10 and Fed. R. Bankr. P. 3001, such as invoices detailing who performed what services and for how long, supporting the reasonableness of the fees); *In re* Sacko, 394 B.R. 90 (Bankr. E.D. Pa. 2008)(disallowing servicer's charges for property inspections, property preservation costs, and escrow advances, and limiting assessment of sheriff's sale costs and attorney fees due to servicer's failure to meet burden of production in documenting need for the charges); *In re* Williams, 1998 WL 372656 (Bankr. N.D. Ohio June 10, 1998) (bank failed to meet burden of proving its fees are reasonable, by failing to provide adequate documentation); *cf. In re* Maywood, Inc., 210 B.R. 91 (Bankr. N.D. Tex. 1997) (fees disallowed for lender's bankruptcy monitor in chapter 11 case when the monitor spent the bulk of his time playing games on his laptop computer, reading the newspaper, and practicing his putting).

If fees or expenses are to be collected from property of the estate, they should be itemized and requested in an application filed pursuant to Federal Rule of Bankruptcy Procedure 2016.

[52] *See* Wells Fargo Bank v. Jones, 391 B.R. 577 (E.D. La. 2008) (mortgage creditor failed to show that monthly property inspections during chapter 13 case were necessary and reasonable); *In re* Stewart, 391 B.R. 327 (Bankr. E.D. La. 2008)(multiple BPO, property inspection, and other fees found unreasonable); *In re* Good, 207 B.R. 686 (Bankr. D. Idaho 1997)(assessing reasonableness of fees charged by mortgage lender). *See also In re* Dalessio, 74 B.R. 721 (B.A.P. 9th Cir. 1987); *In re* Jones, 366 B.R. 584 (Bankr. E.D. La. 2007); *In re* Jemps, Inc., 330 B.R. 258 (Bankr. D. Wyo. 2005) (attorney "thoroughness to the point of overzealousness" not compensable, even if creditor approves, particularly if creditor is oversecured and services not needed to protect its interest).

[53] *In re* Stewart, 391 B.R. 327 (Bankr. E.D. La. 2008) (finding no reasonable basis for assessing multiple drive by inspection charges and paying for broker's price opinion when borrower was current in long term chapter 13 case and servicer was regularly in contact with borrower); *In re* Payne, 387 B.R. 614 (Bankr. D. Kan. 2008) (rejecting servicer's attempt to charge debtor for twenty-three drive by inspections made during period when debtor was in open and clear occupancy of home and in constant contact with servicer).

[54] Fed. R. Bankr. P. 3015, 7004, 9014.

The fee also may be unreasonable if it exceeds the cost of the services performed.[55] Unreasonable or excessive charges may also violate the requirement of good faith and fair dealing implied in any contractual relationship.[56]

If a holder or servicer attempts to collect a bankruptcy fee from property of the estate while the automatic stay is in effect by adding the fee to the debtor's account, it has violated Code section 362(a)(3). Section 362(a)(3) prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate" while the stay is in effect. In a chapter 13 case, all property the debtor acquires during the entire time the case is pending is property of the estate pursuant to section 1306(a). By seeking payment of this fee directly from the debtor, the holder violates the stay.[57] Some courts have held that a creditor must file an application

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[55] *See generally* Franks v. Associated Air Ctr. Inc., 663 F.2d 583 (5th Cir. 1982) (gross overcharges violate UDAP); *In re* Staggie, 255 B.R. 48 (Bankr. D. Idaho 2000) (excessive attorney fees sought under section 506(b) disallowed as not reasonable); Russell v. Fid. Consumer Discount Co., 72 B.R. 855 (Bankr. E.D. Pa. 1987) (grossly excessive fee was unconscionable).

[56] Burnham v. Mark IV Homes, Inc., 387 Mass. 575, 441 N.E.2d 1027, 1031 (1982); *see* U.C.C. § 1-203.

Some state debt collection statutes or regulations apply to creditors as well as debt collectors. *See* National Consumer Law Center, Collection Actions Ch. 11 (2008). The federal Fair Debt Collection Practices Act applies only to third party collectors. However, the FDCPA does apply if the debt was acquired by the debt collector or mortgage lender (or servicer) at a time when the debt was in default. *See* National Consumer Law Center, Fair Debt Collection (6th ed. 2008). Most debt collection statutes and regulations prohibit the collection of any amount not authorized by contract or applicable law. *See, e.g.*, Martinez v. Albuquerque Collection Services, 867 F. Supp. 1495 (D.N.M. 1994) (collection agency violated FDCPA by collecting inflated charges for attorneys fees).

[57] Wells Fargo Bank v. Jones, 391 B.R. 577 (E.D. La. 2008) (mortgage creditor's assessment and collection of undisclosed and improper postpetition inspection fees and other charges violated automatic stay); *In re* Stark, 242 B.R. 866 (W.D.N.C. 1999) (sanctions imposed for violating stay by attempting to collect inspection and monitoring fees); *In re* Payne, 387 B.R. 614 (Bankr. D. Kan. 2008)(unlawful servicer conduct, including assessing undisclosed postpetition fees, may be pursued as automatic stay violation); *In re* Sanchez, 372 B.R. 289, 311 (Bankr. S.D. Tex. 2007) (assessing postpetition attorney's fees, costs, and property inspection fees without court approval violated § 362(a)(3)); *In re* Banks, 31 B.R. 173 (Bankr. N.D. Ala. 1982). *But see* Mann v. Chase Manhattan Mortgage Corp., 316 F.3d 1 (1st Cir. 2003) (mortgage company did not violate automatic stay by adding fees to debtor's account if it never attempted to collect those fees from debtor; court glossed over fact that addition of fees increased lien on debtor's property).

In order to avoid unknown charges being assessed against a debtor's mortgage account, it may be advisable to file a motion at the end of a chapter 13 case seeking an order that the mortgage default has been cured and the mortgage is current. Some courts

under Bankruptcy Rule 2016 before assessing any fee that could be collected from property of the estate.[58] Others have adopted local rules requiring the mortgage holder to give notice to the debtor, debtor's counsel, and trustee of any postpetition fees or changes in the debtor's payments during the plan, and have held that if such notice is not given the increased amounts are waived.[59]

Undisclosed fees and payment changes

In curing a default under section 1322(b)(5), the debtor makes payments under the plan on the prepetition arrearage and provides for the "maintenance of payments while the case is pending." For a cure plan to be successful there must be full disclosure of all postpetition "maintenance" payments.[60] Unfortunately, it has become common for mortgage creditors to add fees and charges to mortgage accounts without notice to the borrower, trustee or bankruptcy court while the bankruptcy case is pending, and without disclosing the fees in a proof of claim or amended claim, and without seeking court approval. Some creditors secretly maintain these charges on the debtor's account while the bankruptcy is pending and wait to collect the fees once the bankruptcy case is closed or when the loan is paid off or refinanced. In some cases, postpetition fees assessed prior to plan confirmation are included in the arrearage amount on the proof of claim but are not separately listed or itemized. Some servicers refuse to provide normal escrow account statements and payment change notices to debtors in bankruptcy, depriving these debtors of the opportunity to pay the amounts due during the chapter 13 case and subjecting them to later collection efforts.[61]

As a result of these practices, debtors who complete their plans often emerge from a chapter 13 case only to have the servicer begin foreclosure anew based on claims of

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have made such a procedure routine, by local rules. *See, e.g., In re* Eddins, 2008 Bankr. LEXIS 2907 (Bankr. N.D. Miss. Oct. 20, 2008).

[58] *E.g.*, In re Moffitt, 408 B.R. 249, 259 (Bankr. E.D. Ark. 2009); *In re* Padilla, 379 B.R. 643 (Bankr. S.D. Tex. 2007).

[59] Armstrong v. Lasalle Bank Nat'l Ass'n, 394 B.R. 794 (Bankr. W.D. Pa. 2008)

[60] *In re* Sanchez, 372 B.R. 289, 297 (Bankr.S.D.Tex. 2007)("in order for the bankruptcy system to function - every entity involved in a bankruptcy proceeding must fully disclose all relevant facts"); *In re* Jones, 366 B.R. 584, 602-03 (Bankr.E.D.La.2007)("Bankruptcy courts can not function if secured lenders are allowed to assess postpetition fees without disclosure and then divert estate funds to their satisfaction without court approval"), *aff'd in part, rev'd in part*, 391 B.R. 577 (E.D. La. 2008).

[61] *E.g.*, *In re* Dominique, 368 B.R. 913 (Bankr.S.D.Fla. 2007)(servicer failed to provide escrow statements during chapter 13 plan and just before plan completion provided debtors with an escrow account review indicating a $6,397 escrow deficiency); *In re* Rizzo-Cheverier, 364 B.R. 532 (Bankr.S.D.N.Y. 2007)(servicer allowed deficiency in escrow account to accrue and then, without notice to debtor, applied trustee plan payments intended for prepetition arrears to postpetition escrow deficiency).

unpaid fees for such items as attorney's fees, property inspections, broker price opinions, and other charges allegedly incurred during the chapter 13 case. The fundamental unfairness of these practices has led a number of courts to find that mortgage holders and servicers waive who fail to disclose fees, payment increases and account deficiencies waive their right to collect these amounts.[62]

Responding to mortgage servicer problems by making use of section 524(i)

Problems with inflated proofs of claims and misapplication of plan payments such as those discussed above can be remedied as violations of the discharge injunction, violation of the debtor's order of confirmation through contempt proceedings, breach of an implied covenant of duty of good faith and fair dealing, and as unfair trade practices.[63]

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[62] Chase Manhattan Mortg. Corp. v. Padgett, 268 B.R. 309 (S.D. Fla. 2001) (servicer waived right to collect escrow account deficiency because it failed to notify borrowers of deficiencies as required by RESPA); Craig-Likely v. Wells Fargo Home Mortgage, 2007 U.S. Dist. LEXIS 29042 (E.D.Mich. Mar. 2, 2007); *In re* Armstrong, 394 B.R. 794, 798-99 (Bankr. W.D. Pa. 2008) (servicer waived right to increased mortgage payments by failing to give notice of payment changes on an adjustable rate mortgage in violation of local rule); *In re* Payne, 387 B.R. 614, 637 (Bankr. D. Kan. 2008)("When a lender silently accepts payments for over three years without notifying the borrower the payments are insufficient, when the borrower believes his taxes and insurance are being paid by his monthly payments to his lender, and when the borrower has no reason to know the lender is advancing taxes and insurance and thereby increasing borrower's indebtedness, the lender waives his right to recover the advances from the borrower."); *In re* Johnson, 384 B.R. 763 (Bankr.E.D.Mich. 2008)(even though debtor's chapter 13 case was dismissed, court found that creditor waived its right to recover arrearage for taxes and insurance by failing over five year period to comply with RESPA and local rule requiring disclosure of payment increases); *In re* Dominique, 368 B.R. 913, 921 (Bankr. S.D. Fla. 2007) (creditor who failed to perform annual escrow analysis and give annual notice of any escrow deficiency waived its right to recover deficiency); *In re* Dominique, 368 B.R. 913 (Bankr.S.D.Fla. 2007).

[63] *See, e.g., In re* Nibbelink, 403 B.R. 113 (Bankr. M.D. Fla. 2009)(punitive damages for postdischarge attempts to collect fees not permitted by chapter 13 plan); *In re* Harris, 312 B.R. 591 (N.D. Miss. 2004) (section 105(a) may be used to enforce Bankruptcy Code provisions that prohibit mortgage lender from charging late fees based on delay by trustee in disbursing postpetition mortgage payments); *In re* Sanchez, 372 B.R. 289 (Bankr. S.D. Tex. 2007)(section 105(a) gave court power to sanction creditor's charging of undisclosed and improper fees); *In re* Rizzo-Cheverier, 364 B.R. 532 (Bankr. S.D.N.Y. 2007)(treating debtor as being in default after she had cured under her plan violated the discharge injunction); *In re* Turner, 221 B.R. 920 (Bankr. M.D. Fla. 1998) (attorneys fees and costs awarded for contempt based on accounting on secured debt inconsistent with completion of confirmed chapter 11 plan); *In re* McCormack, 203 B.R. 521 (Bankr. D.N.H. 1996) (mortgagee bank held liable for $10,000 punitive damages when it did not adjust its computer records to reflect effect of plan confirmation and sent debtor demand letter expressing intent to collect fees that were not due under plan). *But see In re*

In addition, a specific cause of action was created by the 2005 amendments to the Code. Under section 524(i), a creditor's willful failure to credit payments received under a confirmed plan in accordance with the plan constitutes a violation of the injunction of section 524(a).[64] Although section 524(a) previously was limited to violations of the discharge order, section 524(i) is not limited to acts occurring after discharge. A section 524(i) enforcement proceeding will in most instances involve actions taken by a creditor before the discharge is entered.

The section does not apply, however, if confirmation of the plan has been revoked, the plan is in default, or the creditor has not received the plan payments as required by the plan. The provision is also limited to cases in which the failure to credit payments has caused material injury to the debtor.

The willfulness requirement of section 524(i) should not be a significant obstacle for debtors. As in section 362(k)(1), willfulness should be interpreted to mean simply that the creditor intended to commit the act, that is, credit the payment in the manner it did; the debtor should not need to prove that the creditor intended to violate the Code or the plan provisions. Absent a creditor's proof that the improper crediting was a mistake in conflict with the creditor's normal procedures, the creditor should be presumed to have intended its acts.

In an action seeking to establish a violation of section 524(i), the debtor must prove that the creditor failed to credit payments "in the manner required by the plan." Thus, to invoke the protections of section 524(i), the debtor's chapter 13 plan should contain precise language directing how payments are to be applied.[65] If the court's local rules contain provisions which sufficiently direct how payments are to be applied by mortgage creditors, the debtor may wish to incorporate these local rule provisions into the plan by reference.[66]

Joubert, 411 F.3d 452 (3d Cir. 2005) (section 105 does not provide cause of action for violations of section 506(b)).

[64] To facilitate proof of a section 524(i) violation, the debtor's plan should clearly specify how creditor payments are to be applied. Sample plan language is provided in Form 18, Appx. G.3, *infra*. *See also Challenging Mortgage Servicer "Junk" Fees and Plan Payment Misapplication: Making Use of New Section 524(i)*, 25 NCLC REPORTS *Bankruptcy and Foreclosures Ed*. 11 (Nov./Dec. 2006).

[65] *See In re* Nosek, 544 F.3d 34 (1st Cir. 2008) (reversing award of sanctions against mortgage servicer because debtor's plan failed to specify how payments were to be applied).

[66] *In re* Anderson, 382 B.R. 496 (Bankr. D. Or. 2008) (certain plan provisions were "surplusage" because addressed by either contract between the parties or by local rules).

Several courts have provided guidance on the types of plan provisions implementing section 524(i) which may be approved.[67] A plan term may require that upon entry of the confirmation order, the debtor's mortgage account is to be deemed current for purposes of application of ongoing postpetition payments.[68] Courts have uniformly approved plan provisions which require the mortgage holder or servicer to make appropriate adjustments to the ongoing maintenance payments based on the note and security agreement and applicable nonbankruptcy law, including payment changes based on escrow account analysis and interest rate provisions in an adjustable rate mortgage, and to notify the debtor, debtor's attorney and trustee of such payment changes.[69] A plan term

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[67] *E.g.*, *In re* Emery, 387 B.R. 721 (Bankr. E.D. Ky. 2008)(proposed special mortgage provision does not violate section 1322(b)(2)); *In re* Watson, 384 B.R. 697 (Bankr. D. Del. 2008); *In re* Aldrich, 2008 WL 4185989 (Bankr. N.D. Iowa Sept. 4, 2008) (discussing plan provisions that would be presumptively acceptable in future plans); *In re* Andrews, 2007 WL 2793401 (Bankr. D. Kan. Sept. 26, 2007); *In re* Collins, 2007 WL 2116416 (Bankr. E.D. Tenn. July 19, 2007) (plan provisions imposing procedural notice requirements on mortgage creditor do not violate section 1322(b)(2)); *see also In re* Jones, 2007 WL 2480494 (Bankr. E.D. La. Aug. 29, 2007) (describing procedures related to payment application and notification of fees mortgage servicer would need to implement to avoid imposition of sanctions), *remanded*, Wells Fargo Bank v. Jones, 391 B.R. 577 (E.D. La. 2008).

[68] *In re Booth*, 399 B.R. 316 (Bankr. E.D. Ark. 2009); *In re* Ramsey, 2009 WL 3245303 (Bankr.M.D.Tenn. Oct 02, 2009); *In re* Patton, 2008 WL 5130096 (Bankr, E.D. Wis. Nov. 19, 2008); *In re* Emery, 387 B.R. 721 (Bankr. E.D. Ky. 2008); *In re* Andrews, 2007 WL 2793401 (Bankr.D.Kan. Sep 26, 2007); *In re* Collins, 2007 WL 2116416 (Bankr, E.D. Tenn. July 19, 2007). *But see In re* Segura, 2009 WL 416847 (Bankr. D. Colo. Jan 09, 2009)(refusing to approve plan term deeming payments current upon confirmation).

Some courts have approved similar provisions only if qualifying language is added which specifies that the "deeming current" is contingent upon successful completion of the plan. *See., e.g.*, *In re* Nelson, 408 B.R. 394 (Bankr. D.Co. 2009); *In re* Winston, 2009 WL 2883158 (Bankr.N.D.N.Y. May 07, 2009); *In re* Hudak, 2008 WL 4850196 (Bankr. D. Colo. Oct 24, 2008).

[69] *See. e.g., In re* Segura, 2009 WL 416847 (Bankr, D. Colo. Jan. 9, 2009); *In re* Emery, 387 B.R. 721 (Bankr. E.D. Ky. 2008); *In re* Watson, 384 B.R. 697 (Bankr. D. Del. 2008); *In re* Hudak, 2008 WL 4850196 (Bankr. D. Colo. Oct 24, 2008); *In re* Anderson, 382 B.R. 496 (Bankr. D. Or. 2008); *In re* Patton, 2008 WL 5130096 (Bankr, E.D. Wis. Nov. 19, 2008); *In re* Aldrich, 2008 WL 4185989 (Bankr. N.D. Iowa Sept. 4, 2008). *See also In re* Booth, 399 B.R. 316 (Bankr. E.D. Ark. 2009)(provision requiring payment change notice approved but only as to debtor, not trustee and debtor's counsel).

This type of plan provision requires mortgage creditors to service the loan in the customary manner as they would for homeowners outside of bankruptcy. Based on the Real Estate Settlement Procedures Act, this would mean performing an annual escrow analysis and notifying borrowers of any changes in escrow deposits and balances at least once per year within 30 days of the analysis. 12 U.S.C. § 2609. For adjustable rate mortgages based on the Truth in Lending Act, it would require notification of payment

may require a servicer to give notice to the debtor (and the trustee) before it attempts to impose fees and charges that may affect the debtor's postpetition payments.[70] Local court rules can establish a similar requirement.[71] A plan term or local rule should establish a procedure for resolving disputes over these charges and provide that servicers' claims for postpetition fees will be disallowed if the servicer fails to comply with the notice requirement.[72]

In order to avoid unknown charges being assessed against a debtor's mortgage account after the debtor cures the default and the chapter 13 case is closed, it may be advisable to file a motion at the end of a chapter 13 case seeking an order that the mortgage default has been cured and the mortgage is current.[73] Some courts have made such a procedure routine, by local rules.[74]

B. STANDING ISSUES IN BANKRUPTCY PROCEEDINGS

In judicial foreclosures the plaintiff must typically allege in its complaint that it is the current owner of the mortgage and the note being enforced. The court must make findings to this effect before allowing a foreclosure to proceed. Homeowners may challenge judicial foreclosures on a number of grounds related to the authority of the named plaintiff to foreclose. These challenges may go to the court's subject matter jurisdiction over the case and involve standing questions that have constitutional implications. In bankruptcy proceedings similar issues arise. A servicer or mortgagee moving for relief from the bankruptcy stay must satisfy constitutional and related judicial standing requirements. The bankruptcy rules incorporate equivalents to Federal Rule of Civil Procedure 17 (requiring that proceedings be brought in name of the real party in interest) and Federal Rule of Civil Procedure 19 (requiring joinder of all necessary

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amount changes at least 25 days before the due date for the new payment amount. 12 C.F. R. § 226.20(c).

[70] *In re* Segura, 2009 WL 416847 (Bankr, D. Colo. Jan. 9, 2009); *In re* Watson, 384 B.R. 697 (Bankr. D. Del. 2008); *In re* Patton, 2008 WL 5130096 (Bankr. E.D. Wis. Nov. 19, 2008); *In re* Aldrich, 2008 WL 4185989 (Bankr. N.D. Iowa Sept. 4, 2008)(finding plan term requiring annual notice and notice 90 days before final payment be "presumptively acceptable" to the court).

[71] *See e.g. In re* Armstrong, 394 B.R. 794 (Bankr. W.D. Pa. 2008); *In re* Payne, 387 B.R. 614 (Bankr. D. Kan. 2008).

[72] *In re* Aldrich, 2008 WL 4185989 (Bankr. N.D. Iowa Sept. 4, 2008)(plan provision providing for waiver of any undisclosed fees would be "presumptively acceptable" to the court); *In re* Watson, 384 B.R. 697 (Bankr. D. Del. 2008)(plan provision providing for notice of mortgage fees and charges and procedure for handling disputes approved).

[73] An example of such a motion can be found in Form 139, Appendix G.11, *infra*.

[74] *See, e.g., In re* Eddins, 2008 WL 4905477 (Bankr. N.D. Miss. Oct. 20, 2008).

parties).[75] Because they frequently apply these important procedural rules in the context of foreclosures of securitized mortgages, there have been a number of recent bankruptcy court decisions on standing, real party in interest, and necessary party.[76]

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[75] *See In re* Kang Jin Hwang, 396 B.R. 757 (Bankr. C.D. Cal. 2008) (discussing applicability of Fed. R. Civ. P. 17 and 19 in context of securitized mortgage holder's motion for relief from bankruptcy stay).

[76] *See In re* Minbattiwalla, 2010 WL 694166 (Bankr. S.D.N.Y. Mar. 1, 2010) (in addition to establishing rights of the holder, servicer seeking stay relief must show it has authority to act as holder's agent); *In re* Canellas, 2010 WL 571808 (Bankr. M.D. Fla. Feb. 9, 2010) (motion for relief from stay denied after movant produced no evidence of ownership of note; allonge dated inconsistently with trust documents); *In re* Lee, 2009 WL 1917010 (Bankr. C.D. Cal. Jan. 26, 2009) (sanctioning attorney who pursued stay relief motion knowing named party lacked ownership interest in note); *In re* Jacobson, 402 B.R. 359 (Bankr. W.D. Wash. 2009) (servicer's declaration in support of motion for relief from stay did not establish that it had beneficial interest in note); Mortgage Elec. Registration Sys., Inc. v. Medina, 2009 WL 4823387, at *3 (D. Nev. Dec. 4, 2009) (MERS cannot be real party in interest because has no concrete interest in debt obligation); *In re* Mitchell, 2009 WL 1044368 (Bankr. D. Nev. Mar. 31, 2009) (no evidence MERS had any ownership interest in promissory note such as would make it real party in interest), aff'd on other grounds, 2009 WL 5868512 (D. Nev. Dec. 30, 2009) (because MERS cannot comply with court rule requiring participation in settlement negotiations through representative with authority to confer on behalf of true owner, MERS is precluded from filing motion in bankruptcy court); *In re* Fitch, 2009 WL 1514501 (Bankr. N.D. Ohio May 28, 2009) (MERS was never in chain of title for mortgage and note; had no standing); *In re* Sheridan, 2009 WL 631355 (Bankr. D. Idaho Mar. 12, 2009) (MERS failed to show standing to bring motion); *In re* Wilhelm, 407 B.R. 392 (Bankr. D. Idaho 2009) (MERS lacked authority to transfer note; stay relief denied); *In re* Wells, 407 B.R. 873, 878 (Bankr. N.D. Ohio 2009) (the standing requirements a creditor must meet to file a proof of claim and to seek relief from stay are the same); *In re* Waring, 401 B.R. 906 (Bankr. N.D. Ohio 2009) (servicer with no interest in note or authority to act on behalf of owner did not have standing to enter into reaffirmation agreement; requirements a creditor must meet to file a proof of claim and to seek relief from stay are the same); *In re* Kang Jin Hwang, 396 B.R. 757 (Bankr. C.D. Cal. 2008) (denying motion for relief from stay filed by servicer that still possessed note but had sold rights to enforce it to unknown entity); *In re* Vargas, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (servicer's evidence in form of written declaration and testimony of clerical staff not admissible to establish mortgage holder's standing); *In re* Gilbreath, 395 B.R. 356 (Bankr. S.D. Tex. 2008) (entity lacked standing to file proof of claim in bankruptcy case because it failed to file documents showing it was present holder of note); *In re* Nosek, 386 B.R. 374 (Bankr. D. Mass. 2008) (imposing sanctions on creditor for misrepresenting status of holder of note during protracted litigation); *In re* Hayes, 393 B.R. 259 (Bankr. D. Mass. 2008) (trustee for investment trust failed to provide evidence that debtor's mortgage was included in trust; no evidence that servicing agreement authorized servicer to file proof of clam for an identified mortgage holder); *In re* Maisel, 378 B.R. 19 (Bankr. D. Mass. 2007) (servicer bringing stay relief motion failed to document standing as of

Standing challenges to proofs of claim based on securitized mortgage debt

As securitization of mortgages has become widespread, it has become increasingly difficult for mortgage servicers to provide documentation of their standing to assert the rights of mortgage holders. Original documents are lost in the securitization chain and cannot be produced or, when they are located, they are frequently missing the endorsements or assignments necessary to evidence their transfers in the chain. Courts have ruled that without documentary proof that an entity is in fact the party entitled to enforce a mortgage that entity cannot file a proof of claim (or seek relief from the automatic stay.)[77] The use by lenders of the Mortgage Electronic Registration System (MERS) as the named mortgagee in order to avoid normal recording procedures for transfers of mortgages has also led to an inability to enforce loans when proceedings are brought in the name of MERS.[78]

Claimants who file proofs of claim arising out of securitized mortgage debt can face challenges based on standing. In sustaining these challenges courts apply standing principles in much same way they do when they deny motions for relief from the stay for lack of standing.[79] Once a proof of claim loses the presumption of validity due to a failure to comply with the documentation requirements of Bankruptcy Rule 3001(c) and (d), the claimant bears the burden of proof to show it is the holder of the claim or otherwise has standing to enforce the claim. The claimant must prove that it was either the creditor to whom the debt was owed (the current holder of the note) or was an authorized representative of the current note holder when it filed the proof of claim. As has occurred in the stay relief context, courts may find that a mortgage servicer's witnesses who lack first-hand knowledge of a transaction's history are unable to present competent evidence to meet the claimant's burden of proof on standing.[80] Furthermore, because standing goes to the court's subject matter jurisdiction, creditors cannot argue

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time motion filed); *In re* Parrish, 326 B.R. 708 (Bankr. N.D. Ohio 2005) (objection to proof of claim sustained where claimant failed to produce competent evidence it was current holder of note or authorized agent of holder).

[77] *See, e.g, In re* Wells, 407 B.R. 873 (Bankr. N.D. Ohio 2009)(proof of claim was not prima facie valid when note underlying mortgage was never negotiated to entity filing proof of claim).

[78] *In re* Hawkins, 2009 Bankr. LEXIS 877 (Bankr. D. Nev. Mar. 31, 2009). For a detailed discussion of MERS, see National Consumer Law Center, Foreclosures § 4.3.4A (2d ed. 2007 and Supp.).

[79] *See e.g. In re* Wells, 407 B.R. 873, 878 (Bankr. N.D Ohio 2009)(standing requirements a creditor must meet to file a proof of claim and to seek relief from stay are the same). *See generally,* § 9.7.3.1.1, *supra* (discussing objections to movant's standing to file motion for relief from stay).

[80] *In re* Parrish, 326 B.R. 708 (Bankr. N.D. Ohio 2005)(objection to proof of claim sustained where claimant failed to produce competent evidence it was current holder of note or authorized agent of holder). *See also In re* Vargas, 369 B.R. 511 (Bankr. C.D. Cal. 2008)(evidence from a written declaration and from clerical witness not admissible to establish purported mortgage holder's standing to file motion for relief from stay).

that statements in the debtor's schedules or plan acknowledging the party as the holder waive later standing objections.[81]

Defects leading to disallowance of proofs of claim on standing grounds include failure to produce evidence of proper assignments of the note from the original lender to the current claimant and failure to show possession of the note at the time the proof of claim was filed.[82] Loan servicers who have authority to do so from a current note holder may file a proof of claim.[83] However, state laws often require a power of attorney to authorize these actions by an agent.[84] Several courts have denied proofs of claim where limited powers of attorney either did not expressly authorize a party to assign or transfer a note, or did not authorize the claimant to file a proof of claim on behalf of the note holder.[85] Bankruptcy Rule 9011 obligates those filing claims to investigate the facts before filing a claim asserting ownership of an obligation. Courts have imposed or threatened to impose sanctions against counsel and creditors who file proofs of claim without reasonable prior investigation.[86]

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[81] *In re* Newcare Health Corp., 244 B.R. 167 (B.A.P. 1st Cir. 2000).

[82] *In re* Wells, 407 B.R. 873 (Bankr. N.D. Ohio 2009)(evidence failed to show claimant possessed note when filed proof of claim); *In re* Gilbreath, 395 B.R. 356 (Bankr. S.D. Tex. 2008)(claimant lacked standing to file proof of claim because failed to file documents showing it was present holder of note); *In re* Hayes, 393 B.R. 259 (Bankr. D. Mass. 2008)(trustee for investment trust failed to provide evidence that debtor's mortgage was included in trust; no evidence of servicing agreement authorizing servicer to file proof of clam for an identified mortgage holder); *In re* Parrish, 326 B.R. 708 (Bankr. N.D. Ohio 2005)(claimant failed to show it held note or was authorized agent for current holder).

[83] Greer v. O'Dell, 305 F.3d 1297 (11th Cir. 2002)(because authorized servicing agent for creditor had pecuniary interest in claim process, it had standing to file proof of claim); *In re* Conde-Dedonato, 391 B.R. 247 (Bankr. E.D. N.Y. 2008) (same, as to mortgage servicer); *In re* Viencek, 273 B.R. 354 (Bankr. N.D.N.Y. 2002) (mortgage servicer with financial interest in collection of debt met standing requirements to file proof of claim).

[84] The Official Form for a Proof of Claim, Form 10, instructs the person who is filing and signing the claim to attach a copy of a power of attorney, if any.

[85] *In re* Wells, 407 B.R. 873 (Bankr. N.D. Ohio 2009)(limited power of attorney did not authorize servicer to file proof of claim); *In re* Hayes, 393 B.R. 259 (Bankr. D. Mass. 2008)(limited power of attorney did not authorize assignment in chain to current claimant).

[86] *In re* Nosek, 406 B.R. 434 (D. Mass. 2009)(sanctioning servicer and law firm for misrepresenting status of holder of note, including through erroneous proof of claim, during protracted litigation); *In r*e Lee, 408 B.R. 893 (Bankr. C.D. Cal. 2009)(Rule 9011 sanctions imposed for failure to disclose transfer of ownership of note, failure to join true owner in motion for relief from stay, and submission of copy of note that was not true and correct copy of the original); *In re* Hayes, 393 B.R. 259, 269 (Bankr. D. Mass. 2008)(threatening Rule 9011 sanctions for future misrepresentations of claimants' status as holders of notes).

Bankruptcy Rule 9011 and Standing Issues

Counsel preparing foreclosure complaints have an obligation to make a reasonable inquiry to ensure that factual contentions set forth in pleadings have evidentiary support.[87] This duty certainly includes investigation into the facts related to current ownership of notes and mortgages, as these facts form the very basis for the legal action. Courts have become increasingly vigilant in exercising their own authority under Rule 11 to scrutinize mortgage servicers' filings for blatantly inconsistent content related to standing and real party in interest.[88] Careless foreclosure practices undermine the functioning of the courts and harm property rights of homeowners, investors, and purchasers of properties at foreclosure sales. Although Rule 11 does not function primarily as a fees-shifting provision, it does authorize a court to order that the offending creditor pay the objecting homeowner's attorney fees.[89]

Bankruptcy Rule 9011 incorporates Federal Rule of Civil Procedure 11 into bankruptcy proceedings. Thus, when servicers, lenders, and their attorneys file motions for relief from the bankruptcy stay and proofs of claim, they must comply with Rule 9011's reasonable investigation requirement. The bankruptcy courts have been particularly active in enforcing Rule 9011 when servicers and lenders brought matters before the bankruptcy court without reasonable investigation of the creditor's standing.[90] The

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[87] Fed. R. Civ. P. 11.

[88] Bank of New York v. Williams, 979 So. 2d 347 (Fla. Dist. Ct. App. 2008) (attorney fee awarded to homeowner under Florida prevailing party statute after dismissal of foreclosure complaint on standing grounds); Mainsource Bank v. Winafeld, 2008 WL 4061415 (Ohio Ct. App. Sept. 2, 2008) (upholding imposition of Rule 11 sanctions against plaintiff who filed foreclosure action when it was not real party in interest). See also Wells Fargo Bank, N.A. v. Reyes, 867 N.Y.S.2d 21 (N.Y. Sup. Ct. 2008) (table) (scheduling hearing to consider sanctions for frivolous litigation conduct in bringing foreclosure action when public records indicated that mortgage had never been assigned to named plaintiff when action filed); Countrywide Home Loans, Inc. v. Taylor, 843 N.Y.S.2d 495 (N.Y. Sup. Ct. 2007) (sanctions appropriate if plaintiff continues to bring actions accompanied by similar defective documentation of standing).

[89] Fed. R. Civ. P. 11(c)(4). See Kirk Capital Corp, 16 F.3d 1495, 1490 (8th Cir. 1994); *In re* Kunstler, 914 F.2d 505, 522/-/523 (4th Cir. 1990); White v. Gen. Motors Corp. 675, 684 (10th Cir. 1990).

[90] *In re* Nosek, 406 B.R. 434 (D. Mass. 2009) (affirming imposition of sanctions of $250,000 on creditor for misrepresenting status of holder of note during protracted litigation); In re Lee, 408 B.R. 893 (Bankr. C.D. Cal. 2009) (Rule 9011 sanctions imposed on creditor's attorney for failure to disclose transfer of ownership of note, failure to join true owner in motion for relief from bankruptcy stay, and for submitting copy of note with motion that was not true and correct copy of the original note). *See also In re* Fitch, 2009 WL 1514501 (N.D. Ohio May 28, 2009) (not reaching a sanctions ruling, but reprimanding attorney who signed false affidavits of authority to file motion for entity that never authorized the filing); *In re* Wilhelm, 407 B.R. 392, 403 n.20 (Bankr. D. Idaho 2009) (in light of servicer's counsel's "helter-skelter" submissions, court warns "counsel

analyses from these bankruptcy court decisions can provide strong support for advocates seeking to enforce Rule 11 standards under similar state rules.

C. HELPING FAMILIES SAVE THEIR HOMES ACT of 2009

A number of bills introduced in Congress would have repealed the Bankruptcy Code provision prohibiting modification of home secured loans.[91] None of those bills permitting modification of home mortgage in bankruptcy have been enacted. Congress instead has elected to give voluntary loan modification programs an opportunity to address the foreclosure crisis.

In 2009, Congress enacted the Helping Families Save Their Homes Act of 2009.[92] One of its provisions articulates that the loan modification analysis required by the Treasury Department's Home Affordable Modification Program (HAMP) is the standard of the residential mortgage servicing industry for loss mitigation under both federal and state law. Section 129 provides:

> "Standard Industry Practice – The qualified loss mitigation plan guidelines issued by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 shall constitute standard industry practice for purposes of all Federal and State laws."

Private Right of Action for Violation of Mortgage Owner Disclosure

The Helping Families Save Their Homes Act of 2009 also made several amendments to the Truth in Lending Act (TILA) to assist borrowers in determining ownership of their mortgage loans. TILA has long contained a provision requiring the loan servicer to tell

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should gather the appropriate documents and factual data before filing (as required by Rule 9011 in any event), rather than attempting to cure patently defective motions with serial supplemental filings."); *In re* Sheridan, 2009 WL 631355, at *6 n.19 (Bankr. D. Idaho Mar. 12, 2009) (suggesting potential for Rule 9011 violation in filing motion and characterizing movant as real party in interest based solely on undocumented representations made to attorney by servicer); *In re* Vargas, 396 B.R. 511, 521 n.13 (Bankr. C.D. Cal. 2008) (declarant's "total lack of competence" to testify as to real party in interest raised "serious question as to the good faith of counsel for MERS under Rule 9011."); *In re* Hayes, 393 B.R. 259, 269 (Bankr. D. Mass. 2008) ("[i]naccurate representations about the moving party's status as the holder may constitute a violation of Fed. R. Bankr. P. 9011.").

[91] 11 U.S.C. § 1322(b)(2).

[92] Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, 123 Stat. 1632 (2009).

the borrower who is the actual holder of the mortgage.[93] Upon written request from the borrower, the servicer must state the name, address, and telephone number of the owner of the obligation or the master servicer of the obligation.[94]

One problem with this provision's enforcement had been the lack of a clear remedy for the servicer's non-compliance. However, the Helping Families Save Their Homes Act of 2009 amends TILA to explicitly provide that violations may be remedied by TILA's private right of action found in § 1640(a), which includes recovery of actual damages, statutory damages, costs and attorney fees.[95] The amendment adds the owner disclosure provision found in § 1641(f)(2) to the list of TILA requirements that give rise to a cause of action against the creditor if there is a failure to comply.

The TILA provision does not specify how long the servicer has to respond to the request. Perhaps because no parties were directly liable under § 1640(a) for violations of the disclosure requirement before the 2009 amendment, no case law had developed on what is a reasonable response time. In the future, courts may be guided by recent regulations issued by the Federal Reserve Board requiring servicers to provide payoff statements within a reasonable time after request by the borrower.[96] In most circumstances, a reasonable response time is within five business days of receipt.[97] Applying this benchmark to § 1641(f)(2) requests would seem appropriate since surely no more time is involved in responding to a request for ownership information than preparing a payoff statement. Alternatively, a 30-day response period should be the outer limit for timeliness since that is the time period Congress used in § 1641(g).

Mortgage Transfer of Ownership Notices

The Helping Families Save Their Homes Act of 2009 (the "2009 Act") also amended the Truth in Lending Act to require that borrowers be notified whenever ownership of their mortgage loan is transferred.[98] The new owner or assignee must notify the borrower in writing, within 30 days after the loan is sold or assigned, of its identity, address, telephone number, and the date of transfer and location where the transfer is recorded. In addition, the new owner must disclose how the borrower may reach an agent or party with authority to act on behalf of the new owner, and any other relevant information.[99]

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[93] 15 U.S.C. § 1641(f). The provision also should require disclosure to the borrower's advocate with a properly signed release form.
[94] If the service provides information about the master servicer, a follow-up request should be made to the master servicer to provide the name, address, and telephone number of the owner of the obligation.
[95] *See* 15 U.S.C. § 1640(a).
[96] Reg Z § 226.36(c)(1(iii).
[97] Official Staff Commentary § 226.36(c)(1)(iii)-1.
[98] 15 U.S.C. § 1641(g)(1)(A)–(E).
[99] 15 U.S.C. § 1641(g)(1)(C) and (E).

The law became effective upon enactment, May 20, 2009. Failure to comply with these requirements gives rise to a private right of action, which includes recovery of actual damages, statutory damages, costs, and attorney fees.[100] Borrowers may be entitled to multiple statutory damages of up to $4,000 per violation each time the rule is not complied with.

FRB Issues Interim Final Rule

To implement the statutory requirements for mortgage transfer notices, the Federal Reserve Board issued an Interim Final Rule on November 20, 2009, which initially became effective on an optional basis on that date.[101] Compliance with the Interim Final Rule became mandatory on January 19, 2010.[102]

Scope of Rule's Coverage

In general, TILA and Regulation Z apply only to persons to whom an obligation is initially made payable and that regularly engage in extending credit. However, the 2009 Act's new transfer notice requirement is not limited to loan originators and is intended to apply to persons who acquire ownership of an existing debt. The rule uses the term "covered person" rather than "creditor" to describe persons subject to its requirements. Hopefully the Board will clarify in the final rule that a "covered person" is a "creditor" for purposes of application of the remedy provisions in 15 U.S.C. § 1640(a), so that there is no ambiguity that a "covered person" who fails to comply with the statute and rule is liable for damages.

To become a "covered person" under the rule, a person must become the owner of the mortgage loan by acquiring legal title to the debt obligation.[103] The person must also acquire more than one mortgage loan in any twelve-month period.[104] The rule applies even if ownership is transferred to a different legal entity based on a merger, acquisition, or reorganization.[105]

By specifying that legal title must be acquired, the rule does not apply to a person who acquires only a beneficial interest or security interest in the loan.[106] For example, if the owner of a mortgage loan uses the loan as security to obtain financing, the lender providing the financing is not a "covered person" under the rule. It is not clear whether the rule will permit evasion of the statutory requirement when there have been transfers of

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[100] 15 U.S.C. § 1640(a).
[101] *See* 74 Fed. Reg. 60,143 (Nov. 20, 2009).
[102] The FRB has sought comments on Interim Final Rule, which were due by January 19, 2010. Any additional changes to the Rule based on comments received will be reported in future NCLC publications.
[103] Reg. Z § 226.39(a)(1).
[104] *Id*.
[105] Official Staff Commentary § 226.39(a)(1)-4.
[106] Official Staff Commentary § 226.39(a)(1)-2.

the debt obligation, but legal title is purportedly retained by the Mortgage Electronic Registration System (MERS).[107] However, as a nominee only, MERS generally claims to hold title to the mortgage, but not the note.[108] Therefore transfers of the note's ownership within the MERS system should be subject to the rule. In any event, the Board should clarify in a final rule that transfers between members in the MERS system are subject to the disclosure requirements.

The Commentary notes that the rule does not apply to a party that assumes credit risk without acquiring legal title to loans.[109] Thus, an investor that acquires mortgage-backed securities, pass-through certificates, or participation interests and does not directly acquire legal title in the underlying mortgage loans is not covered. This was apparently intended to exempt entities such as Ginnie Mae when it serves as a guarantor of securities and obtains equitable title to loans. However, if the issuer of the securities defaults and Ginnie Mae then acquires legal title to the loans, Ginnie Mae would be required to comply with the rule.

The rule also provides an exception for mortgage servicers in certain situations, consistent with the TILA assignee liability provision in 15 U.S.C. § 1641(f)(2). If the servicer holds legal title to the loan or the obligation is assigned to the servicer "solely for the administrative convenience of the servicer in servicing the obligation," the servicer is not a "covered person" under the rule.[110] This servicer exemption should not apply to transfers to MERS, however, since MERS is not a servicer and claims no rights to any payments made on the mortgage loans or to any servicing rights related to mortgage loans.[111] Servicers remain obligated, however, to respond to borrower requests under § 1641(f)(2) for the name, address, and telephone number of the loan owner. As for the type of mortgage transaction covered, the rule applies to any consumer credit transaction that is secured by the principal dwelling of a consumer.[112] This includes loans secured by manufactured homes that are a consumer's principal dwelling. The Commentary makes clear that closed-end mortgage loans as well as home equity lines of credit are covered by the rule.[113] The disclosure requirements do not apply to mortgage loans on investment property and those not primarily for personal, family, or household purposes.

Disclosure Requirement

The disclosures required by the 2009 Act must be mailed or delivered on or before the 30th calendar day following the date the covered person acquires the loan.[114] For example, if a covered person acquires a mortgage loan on March 1, the disclosure must

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[107] For information about MERS, *see* NCLC's Foreclosures § 4.3.4A (2009 Supp.).
[108] Mortgage Elec. Registration Sys., Inc. v. Estrella, 390 F.3d 522, 524–525 (7th Cir. 2004).
[109] *Id*.
[110] Reg. Z § 226.39(a)(1).
[111] *See* NCLC's Foreclosures § 4.3.4A (2d ed. and 2009 Supp.).
[112] Reg. Z § 226.39(a)(2).
[113] Official Staff Commentary § 226.39(a)(2)-1.
[114] Reg. Z § 226.39(b).

be mailed or delivered on or before March 31. The acquisition date is the date that is recognized in the books and records of the acquiring person.[115]

The rule provides that if there is more than one consumer liable on the mortgage, disclosures may be sent to any consumer who is "primarily liable."[116] No definition of "primarily liable" is provided. As a result, a transfer notice could be sent to one spouse even though the other spouse is paying all the bills. This is particularly problematic if joint obligors are not living together. The Board should require that transfer notices be provided to all consumers on the note.

The rule provides an exception for temporary holders of mortgage loans. If a covered person sells or transfers legal title to the mortgage loan on or before the 30th calendar day after the covered person acquired the mortgage loan, the covered person is not required to provide the disclosure.[117] The transferee in that situation who subsequently becomes a covered person would be required to give the disclosure if the loan is not transferred again within 30 days. The Board suggests this exception will prevent borrowers from being confused by multiple disclosures they would receive if the various entities that might briefly hold a mortgage loan during the securitization process were required to comply. Unless this provision is changed by the Board in the final rule, practitioners may need to investigate intermediate transfers to determine who should receive rescission notices or whether a proper chain of title leads to the current holder.[118]

Content of Required Disclosures

The notice sent to the borrower must identify the loan that was acquired or transferred. The covered person is given flexibility on how to disclose this, such as by providing the property address along with the pre-transfer account number, or the date when the credit was extended and the original loan amount or credit line.[119] In addition to identifying the loan, the notice sent to the borrower must contain disclosure of the following four categories of information:

1. ***Identity, Address, and Telephone Number.*** The covered person under the rule who is the party acquiring the loan must disclose its name, address, and telephone number.[120] This information must be provided even if there is another party who

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[115] Reg. Z § 226.39(b)(1).
[116] Reg. Z § 226.39(b)(2).
[117] Reg. Z § 226.39(c)(1).
[118] Similarly, there is an exception for repurchase agreements. If a mortgage loan is transferred to a covered person in connection with a repurchase agreement and the transferor that is obligated to repurchase the loan continues to recognize the loan as an asset on its own books for accounting purposes, the covered person acquiring the loan is not required to provide the disclosures. However, if the transferor does not repurchase the mortgage loan, the acquiring party must make the disclosures within 30 days after the date that the transaction is recognized as an acquisition in its books. Reg. Z § 226.39(c)(2).
[119] Official Staff Commentary § 226.39(d)-1.
[120] Reg. Z § 226.39(d)(1).

is servicing the loan.[121] If there is more than one covered person, the information shall be provided for each of them. The covered person may, at its option, provide an e-mail or website address but is not required to do so.

2. ***Acquisition Date.*** The covered person must disclose the date that the loan was acquired.[122] The acquisition date is the date that is recognized in the books and records of the acquiring person.[123]

3. ***Agent's Contact Information.*** The notice sent to the borrower must disclose how to reach an agent or party having authority to act on behalf of the covered person.[124] The notice must identify a person (or persons) authorized to receive legal notices on behalf of the covered person and resolve issues concerning the consumer's payments on the loan.[125] The rule does not require the covered person to appoint persons for these purposes if they do not exist when the loan is acquired. The Board's position in including agents for receipt of legal notice is helpful in carrying out at least one purpose of the 2009 Act, which is to provide the borrower with the identity of persons to whom the borrower may wish to send notice of the extended right of rescission.

   If the owner authorizes separate parties to act on its behalf for different purposes, the notice must provide contact information for each agent. When multiple agents are listed, the notice should describe how the authority for each agent differs, noting for example that one agent is authorized to receive legal notice and another to resolve payment disputes.

   A covered person may comply by simply providing the phone number for the agent, if the consumer can use the phone number to obtain the agent's address.[126] This is unfortunate since borrowers may not be aware that an oral communication with the agent listed as dealing with payment disputes, which is the servicer in most cases, will not be treated as a qualified written request under the Real Estate Settlement Procedures Act.[127] Hopefully the Board will reconsider this position after receiving comments and require that servicer's address for receipt of qualified written requests be listed and information about RESPA rights be provided.

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[121] A different statute, the Real Estate Settlement Procedures Act, requires the borrower to be notified if servicing of the loan is transferred from one entity to another. 12 U.S.C. § 2650(b). *See* NCLC's Foreclosures § 8.2.3.2 (2d ed. 2007 and Supp.).
[122] Reg. Z § 226.39(d)(2).
[123] Reg. Z § 226.39(b)(1).
[124] Reg. Z § 226.39(d)(3).
[125] *Id*.
[126] *Id*.
[127] 12 U.S.C. § 2605(e).

4. ***Recording Location.*** The 2009 Act provides that the notice disclose "the location of the place where transfer of ownership of the debt is recorded."[128] Because the statute refers to ownership of the debt, the Board has construed the requirement as applying only if transfer of the debt's ownership has been recorded. This interpretation renders it meaningless since transfers of debt ownership are generally not recorded in public land records. The Board at a minimum should require disclosure of the location where the covered person's security interest in the property is located.

Optional Disclosures

The 2009 Act provides that the party acquiring a loan shall notify the borrower of ''any other relevant information regarding the creditor."[129] The Board interprets the statutory language as giving it authority to impose additional requirements by regulation after notice and comment, and seeks comment on whether the rule should include additional requirements. At least until the Board receives comment, the Board has taken the position that the statute does not require covered persons to "determine independently what additional information a reviewing court might subsequently determine to be legally relevant in order to avoid liability."[130]

Other Statutory Changes Not Addressed

TILA has long had a provision, even before the 2009 Act, which requires a loan servicer to respond to a written request from the borrower seeking the identity of the owner of the obligation.[131] Before the 2009 Act, however, there was not a clear remedy if the servicer failed to comply. An amendment to TILA made by the 2009 Act now explicitly provides that violations of this disclosure requirement may be remedied by TILA's private right of action.[132] The Board did not include in the interim final rule instructions for complying with this existing requirement.

D. NEW HAMP GUIDELINES

With Supplemental Directive 10-02,[133] the Treasury Department (Treasury) has modified the borrower communication, foreclosure procedures, and bankruptcy law provisions of the Home Affordable Modification Program (HAMP). The HAMP program is designed to get servicers to offer affordable loan modifications to borrowers for their first lien mortgage loans. The new directive, effective on June 1, 2010, requires that servicers improve their borrower outreach and communication efforts, and refrain from referring a

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[128] 15 U.S.C. § 1641(g)(1)(D).
[129] 15 U.S.C. § 1641(g)(1)(E).
[130] *See* 74 Fed. Reg. 60,148 (Nov. 20, 2009).
[131] 15 U.S.C. § 1641(f)(2).
[132] *See* 15 U.S.C. § 1640(a).
[133] Available at https://www.hmpadmin.com/portal/docs/hamp_servicer/sd1002.pdf.

loan to foreclosure until the (a) borrower is determined to be ineligible for HAMP or (b) reasonable solicitation efforts have failed.

In addition, servicers are required to consider borrowers in active chapter 7 or chapter 13 cases for a HAMP modification if requested by the borrower, borrower's counsel or bankruptcy trustee. Other changes were made to facilitate HAMP modifications for debtors in bankruptcy.

Prohibition against Referral to Foreclosure

Supp. Dir. 10-02 provides that, as of June 1, 2010, a servicer may not refer a loan to foreclosure or conduct a scheduled foreclosure sale until either (a) the borrower is evaluated for HAMP and determined to be ineligible, or (b) reasonable attempts to solicit the borrower have been unsuccessful.[134]

Importantly, in a drastic change from prior Treasury guidance, all foreclosure activity must cease once a borrower is in a trial period plan, even if the loan had previously been referred to foreclosure.[135] The servicer must take all reasonable efforts to take actions within its authority to halt further activity in the foreclosure process, whether judicial or non-judicial, once the borrower enters into a trial period plan based on verified income. In other words, servicers are no longer permitted to accept trial plan payments and simultaneously going forward with foreclosure proceedings on a separate track.

The servicer does not violate this provision if it:

- a state foreclosure court, bankruptcy court, or public official refuses to stop proceedings after requested to do so by the servicer;
- the servicer must take action to protect the interest of the investor; or
- there is not sufficient time to stop the activity or event (but the servicer must not permit a sale to go forward).

If a borrower is denied a HAMP modification, the servicer is required by Supp. Dir. 09-08 to send a written Non-Approval Notice. Per the new guidance, the servicer may not conduct a foreclosure sale within 30 days of the Non-Approval Notice, or any longer period that is needed to consider supplemental material provided by the borrower.[136] However, this 30-day window does not apply if the modification is not approved because

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[134] A servicer may also refer a loan to foreclosure or continue with a planned foreclosure sale for other reasons, including if the borrower fails to make payments under an offered trial period plan, or declines to participate in the HAMP program.

[135] If the borrower fails to make a payment, the servicer may proceed with the foreclosure process.

[136] This provision should be read in connection with the provisions in Supp. Dir. 09-08, which may extend the time to foreclosure sale beyond 30 days if the servicer needs to resolve "inconsistencies" in the NPV test.

the property or mortgage is ineligible, the borrower withdraws from the program, or the borrower fails to make payments under a trial or permanent HAMP modification.[137]

What Constitutes Reasonable Solicitation

Servicers must pre-screen all first-lien mortgages when two or more payments are due and unpaid to determine whether they qualify for the basic criteria under HAMP.[138] Servicers are also now required to proactively solicit borrowers whose mortgage loan passes this initial pre-screen, unless they have documented that the borrower is not willing to participate in HAMP.

A servicer is deemed to have made a "Reasonable Effort" to solicit a borrower if over a period of 30 calendar days: (1) the servicer makes a minimum of four telephone calls at different times of day; and (2) the servicer sends two written notices clearly describing HAMP, one certified/express mail and one regular mail.

If the servicer is successful in contacting the borrower and the borrower wishes to participate in HAMP, the servicer must send a written communication via regular or electronic mail describing the initial package required to be submitted by the borrower to request a HAMP modification.[139] The servicer is not required to send the initial package if it determines that the borrower does not meet the basic eligibility criteria for a HAMP modification or the borrower's monthly mortgage obligation is substantially less than 31% of the borrower's gross monthly income.

Deadline for Suspension of Foreclosure Sales

Supp. Dir. 10-02 imposes a deadline for the suspension of foreclosure sales: when a borrower submits a request for HAMP consideration after the sale has been scheduled and the request is received no later than midnight of the seventh business day prior to the foreclosure sale date, the servicer must halt the sale.

The borrower is deemed to have made a request for HAMP modification when it submits a complete Initial Package (RMA, Form 4506T-EZ, evidence of income). The servicer is

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[137] These exceptions indicate that Treasury intends that each borrower be considered for a full evaluation and eligibility be determined before a referral to foreclosure can occur, including the running of an NPV test.

[138] One-to-four unit residential property, occupied by buyer as primary residence, not vacant or condemned, originated on or before January 1, 2009, unpaid principal balance does not exceed $729,750 for a one-unit dwelling (higher amounts for larger dwellings) and was not previously modified under HAMP.

[139] This communication must: (1) include a description of the income evidence required for a HAMP modification; (2) provide the Request for Modification and Affidavit (RMA) and, if necessary, a Hardship Affidavit; and (3) include IRS Form 4506T-EZ or IRS Form 4506T.

permitted, in its discretion, to impose additional requirements for requests received later than 30 days prior to the scheduled foreclosure sale.[140]

Mitigating the Impact of Foreclosure

Supp. Dir. 10-02 also requires that servicers take steps to mitigate the impact of foreclosure. For example, when a borrower is simultaneously in foreclosure and either being evaluated for HAMP or is in a trial period plan, the servicer must provide the borrower with a written explanation and make clear that while certain foreclosure actions may continue, the home will not be sold at sale.

A servicer is now also required to provide to the foreclosure attorney/trustee a written certification that the borrower is not eligible for a HAMP modification before a foreclosure sale may be conducted. The certification must be provided within seven days prior to the scheduled foreclosure sale date.

In addition, servicers are required, within 90 days of signing a Servicer Participation Agreement with Treasury, to review all agreements to determine investor participation in HAMP. Within 30 days of identifying a non-participating investor, the servicer must contact the investor in writing and encourage it to permit modifications under HAMP. This standard appears largely toothless, but an attorney can use the Truth in Lending Act to obtain the investor's identity[141] and then try to find out whether the servicer has complied with its obligation to request participation. Servicers are also required to provide Fannie Mae, HAMP's Program Administrator, with a list of investors that do not participate in HAMP.

Limitations of the Supplemental Directive

Supp. Dir. 10-02 only forbids servicers from referring a mortgage loan to foreclosure until (1) the borrower is determined to be HAMP-ineligible, or (2) solicitation efforts have failed. If the servicer determines the borrower is not eligible for a modification or the solicitation efforts have failed, it may refer the loan to foreclosure.

In addition, the new guidance does not forbid servicers from proceeding with foreclosure actions that are already pending as of June 1, 2010 (at least until a trial modification based on verified income, as described in Supp. Dir. 10-01, has begun). This means that if a borrower is already in foreclosure on June 1, 2010, the servicer may proceed with any and all foreclosure actions, including a sale.

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[140] For example, a servicer may require that a complete Initial Package be delivered through certified/express delivery mail with return receipt/delivery confirmation to either the servicer or the foreclosure attorney/trustee. Any such requirement must be posted on the servicer's website and communicated to the borrower in writing.

[141] *See* 15 U.S.C. § 1641(f)(2).

If the borrower is denied a loan modification, or misses a payment, the servicer may proceed with foreclosure activities to the point of sale, even if the borrower is contesting the denial.

Practice Pointers

If a foreclosure sale has already occurred, ask the foreclosure attorney/trustee for the servicer's certification that the borrower was HAMP-ineligible. If the certification is missing or inaccurate, this should strengthen the case for a wrongful foreclosure action. In the same vein, servicers are now required to have a procedure under which a borrower can escalate disagreements to a supervisory level, and the failure to establish such a procedure can be additional grounds for contesting a sale or denial of modification.

Some borrowers have run into situations in which servicers are asking them to submit income or property valuations repeatedly. Supp. Dir. 10-02 makes clear that servicers must have procedures in place to "ensure that borrowers are not required to submit multiple copies of documents."[142] Documentation under HAMP remains current for 90 days after the time the servicer receives it.[143] The program does not require verified income to be resubmitted before a permanent modification is granted, nor does the property valuation need to be updated.[144]

Finally, be sure to remind the server of the timelines established by Supp. Directives 09-07 and 10-01. The servicer is required to provide a notification of receipt within ten business days. Supp. Dir. 10-01, p. 2. The servicer is also required to provide a notification of a decision or of incomplete submissions within 30 calendar days and any request for submissions beyond this 30 days is untimely. Supp. Dir. 10-02, p. 3.

If the servicer is not complying with these timelines, it might be necessary to escalate. The appropriate email address is escalations@hampadmin.com and the telephone number is 1-866-939-4469.

Borrowers in Bankruptcy

Supp. Dir. 10-02 makes clear that borrowers in active chapter 7 and 13 cases are eligible for a HAMP modification. This is a marked departure from Treasury's prior guidance in HAMP Supp. Dir. 09-01, which provided that borrowers in bankruptcy were eligible for HAMP modifications "at the servicer's discretion." In addition, borrowers who are in a trial period plan and subsequently file for bankruptcy may not be denied a HAMP modification on the basis of the bankruptcy filing.

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[142] Supp. Dir. 10-02, p. 4.
[143] Supp. Dir. 10-01, p. 2.
[144] Supp. Dir. 09-07, pp. 2, 6.

While servicers are not required to actively solicit borrowers in active bankruptcy cases, they must consider them for a HAMP modification if the borrower, borrower's counsel or bankruptcy trustee submits a request to the servicer.

The guidance provides that servicers are required to work with the borrower and borrower's counsel to obtain any court and/or trustee approvals required in accordance with local rules and procedures. Some courts have required that a motion be filed seeking approval of a permanent modification, while others have permitted approval to come from the trustee followed by the submission of an agreed order.

Borrowers in a trial period plan might run up against the three-month trial modification deadline if it takes any significant amount of time to obtain court and/or trustee approvals. In such a case, Supp. Dir. 10-02 provides that servicers "should" extend the trial plan period to accommodate delays in obtaining such approvals, but are not required to extend the trial period beyond two months, resulting in a five-month trial period.

The guidance reiterates Treasury's previous position in Supp. Dir. 09-01 that borrowers who have received a chapter 7 discharge and did not reaffirm the mortgage debt are nonetheless eligible for a HAMP modification. The following language must be inserted into the modification agreement: "I was discharged in a Chapter 7 bankruptcy proceeding subsequent to the execution of the Loan Documents. Based on this representation, Lender agrees that I will not have personal liability on the debt pursuant to this Agreement."

Protection from Plan Objections, Stay Relief and Dismissal Motions

Supp. Dir. 10-02 also addresses the problem of servicers filing motions for stay relief and/or plan objections while the debtor is being considered for a modification. For example, servicers have filed objections on the grounds that the debtor/borrower is not making the full mortgage payment, even though they have been making payments under the trial period plan.

Under the new guidance, if a borrower in an active chapter 13 case is in a trial period plan and makes post-petition payments in the amount required by the trial period, the servicer may not object to confirmation, move for stay relief, or move for dismissal on the grounds that the debtor did not pay the non-modified mortgage payments. While this provision does not apply if the borrower has not yet begun a trial period plan at the time of filing, it should reduce unnecessary litigation costs for borrowers.

Document Requirements

For purposes of determining income eligibility, the servicer may accept copies of the bankruptcy schedules and tax returns (if required to be filed) in lieu of the RMA and Form 4506T-EZ. If the schedules are more than 90 days old, the borrower must provide the servicer with updated income information. Borrowers are still required to provide a Hardship Affidavit (or RMA).

Servicer may Waive Trial Plan for Chapter 13 Borrower

Supp. Dir. 10-02 also provides that borrowers in an active Chapter 13 case who are HAMP-eligible may be converted to a permanent modification without completing the trial period if: (1) the borrower makes all post-petition payments on the mortgage to be modified and at least three of the payments are greater than or equal to the modified payment; (2) the bankruptcy court approves the modification; and (3) the trial period plan waiver is permitted by the investor guidelines. However, waivers under this approach are contingent on the development of "systems capability" and at the discretion of the servicer. It remains unclear whether servicers will in fact waive the trial period or whether the investor guidelines permit such a waiver.

Notice Requirements Under HAMP

Many borrowers—potentially hundreds of thousands—have been left in limbo by servicers, unsure of the status of their Home Affordable Mortgage Program (HAMP) applications. Many have had foreclosure sales scheduled or completed while their servicers were considering them for HAMP, in violation of the servicers' contract with Treasury.[145] This article discusses two tools for obtaining information from the servicer about a borrower's HAMP application: Supplemental Directive 09-08 and the servicer provisions of the Real Estate Settlement Procedures Act. Both—at least in theory—can be used not only to obtain information, but to prevent a foreclosure sale and force a proper evaluation of the borrower for a HAMP modification. Discovery is, of course, another option for acquiring information from servicers.

Obtaining information about the status and substance of the servicer's evaluation of a borrower is important because it can be used to show that a foreclosure sale has been improperly scheduled or that foreclosure can be avoided through appropriate application of the HAMP guidelines. Many courts, even in non-judicial states, consider foreclosure to be an equitable remedy only available if the foreclosing entity has proceeded properly and with "clean hands."[146]

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[145] A survey of consumer advocates conducted by NCLC and NACA found that almost 95% of respondents had worked with at least one client who had a foreclosure sale scheduled during HAMP review. 14% of respondents had had more than 50 clients facing improper foreclosure sales. Available at: www.consumerlaw.org/issues/foreclosure/content/NCLC-NACA-Foreclosure-Sale-Survey-ResultsJan2010.pdf.

[146] *See* NCLC, *Foreclosures* § 6.4.5 (2d ed. 2007 and Supp.). For a particularly strict application of this principle, resulting in the cancellation of the underlying mortgage, see IndyMac Bank v. Yano-Horoski, 2009 WL 3858797 (N.Y. Sup. Ct. Nov. 19, 2009). *See also* Woods v. Monticello Dev. Co., 687 P.2d 1324 (Colo. Ct. App. 1982) ("Equitable remedies are not automatic—the term itself implies a balancing."); Sovereign Bank,

What Does the Servicer Need to Disclose - Supplemental Directive 09-08

Supplemental Directive 09-08 (Supp. Dir. 09-08),[147] released in November, 2009, purports to provide for servicer accountability. It requires notices to borrowers who fail to qualify for a trial or permanent HAMP modification, or who default on a trial modification, listing the reason for the non-approval. Supp. Dir. 09-08 also requires servicers to provide some elements of the Net Present Value (NPV) test upon request. The absence of the borrower notices required by Supp. Dir. 09-08 can be used to argue that the borrower is still being considered for HAMP, and that a foreclosure sale should therefore not take place.[148]

Supp. Dir. 09-08 became effective January 1, 2010, so any borrower whose eligibility for a HAMP modification had not been determined by that date should receive notice if later determined to be ineligible. Supp. Dir. 09-08's notice requirements apply if a borrower is not offered a Trial Period Plan, a permanent HAMP modification, or if the servicer contends that eligibility may be denied because the borrower has not provided financial information.[149] The notice must provide the primary reason or reasons for the non-approval.[150] Importantly, if the notice discusses other non-HAMP loss mitigation options that are being considered or offered to the borrower, it must clearly state that the borrower was considered for but is not eligible for HAMP.

When the reason for non-approval of a trial or permanent modification is a negative result on the NPV test, the servicer must inform the borrower that she has the option of requesting certain data related to the NPV test.[151] The borrower (or her representative) has 30 calendar days from the date of the notice of non-approval to request the NPV data. The servicer must provide it within 10 business days of the request. The servicer is not allowed to proceed to a foreclosure sale until 30 calendar days after the NPV data is given to the borrower, to allow the borrower time to identify potential errors. If the borrower finds "material" errors, the servicer must redo the NPV test. By triggering a 30-day period of ostensible protection from foreclosure sale, a request for the NPV inputs provides an opportunity for borrowers and their advocates to discover whether errors have been made.

F.S.B. v. Kuelzow, 687 A.2d 1039 (N.J. Super. Ct. App. Div. 1997) ("Foreclosure is a discretionary remedy."); M & T Mortg. Corp. v. Foy, 858 N.Y.S.2d 567 (N.Y. Sup. Ct. 2008) ("The courts are not merely automatons mindlessly processing paper motions in mortgage foreclosure actions most of which proceed on default."); Rosselot v. Heimbrock, 561 N.E.2d 555 (Ohio Ct. App. 1988).

[147] All Supplemental Directives are available at www.hmpadmin.com/portal/programs/hamp/servicer.html.

[148] *See* Supp. Dir. 10-02.

[149] Supp. Dir. 09-08, at 1.

[150] The notices must comply with the Equal Credit Opportunity Act, when applicable. Supp. Dir. 09-08, at 1.

[151] For a discussion of the factors considered under the NPV test, s*ee* NCLC, Foreclosures § 2.3.4A (2009 Supp.).

Although somewhat useful, Supp. Dir. 09-08 has a number of weaknesses:

- Investor or guarantor rules can be listed as the reason for rejection, but the identity of the investor, the source of purported conflict (such as the PSA) and evidence of the servicer's required efforts to get a waiver are not provided;
- The borrower must make an affirmative request for the NPV values, adding a cumbersome extra step;
- Servicers are only required to provide some of the NPV values[152]—notable exceptions include the market value of the property and how it was determined, the terms of the modified loan that were used for the test, and the numerical values of the NPV results for modification versus rejection (critical for knowing how far the borrower is from qualifying); and
- NPV retesting is only required if the borrower finds "material" inaccuracies "likely to change the NPV outcome." This effectively leaves the decision to retest in the hands of frontline servicer staff, without meaningful standards, despite the fact that only minimal effort would be required to redo the NPV test for *any* error pointed out by the borrower.

In addition, Supp. Dir. 09-08 fails to address ongoing concerns that the NPV test itself is not publicly available, that there is no meaningful appeal process for HAMP denials (borrowers are directed to contact the HOPE Hotline for escalation), and that servicers persistently lose borrower submissions and fail to stop scheduled foreclosure sales in accordance with HAMP requirements.

Getting the Full Story - Send a QWR Under RESPA

Complete NPV information, as well as other records of the servicer's eligibility determination should be obtainable under the Real Estate Settlement Procedures Act (RESPA), which imposes requirements on servicers to respond to borrower requests for information or correction of account errors.[153] The servicer's obligation is triggered by receipt of a "qualified written request" (QWR) from the borrower or her representative, sent to an address for receipt of QWRs if so designated by the servicer,[154] that includes

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[152] Available NPV inputs are: a) unpaid balance on the original loan as of [data collection date]; b) interest rate before modification as of [data collection date]; c) months delinquent as of [data collection date]; d) next ARM reset date (if applicable); e) next ARM reset rate (if applicable); f) principal and interest payment before modification; g) monthly insurance payment; h) monthly real estate taxes; i) monthly HOA fees (if applicable); j) monthly gross income; k) borrower's total monthly obligations; l) borrower FICO; m) co-borrower FICO (if applicable); n) zip code; and o) state. SD 09-08, at A-2.

[153] 12 U.S.C. § 2605. *See also* Regulation X, the implementing regulation for RESPA, especially 24 C.F.R. § 3500.21.

[154] S*ee* NCLC, *Foreclosures* § 8.2.2.3 (2d ed. 2007 and Supp.).

sufficient information to identify the borrower's account and provides the "reasons for the belief … that the account is in error" or "sufficient detail" to the servicer regarding the information requested.[155] The servicer must acknowledge receipt within 20 business days and take action on the request within 60 business days (closer to 3 months on the calendar).

The power of a QWR to get complete information about the servicer's consideration of a borrower for HAMP has yet to be tested (at least as reflected in court opinions). The information available through a QWR is limited to information "relating to the servicing" of the loan.[156] HAMP activities should qualify because loss mitigation has become a routine function of servicers in the servicing of mortgage loans, and the only method of obtaining a HAMP modification based on the design of the program is through a participating servicer. But some servicers resist providing anything other than payment and escrow information.[157]

If servicers do not provide requested information after conducting an investigation, they must provide the borrower with an explanation of why the information "is unavailable or cannot be obtained by the servicer."[158] Because of servicers' extensive reporting obligations under HAMP, nothing that a borrower might request is likely to be actually unavailable or unobtainable by the servicer.[159]

Servicers also sometimes claim that requested information is privileged or confidential, even though there is no language in RESPA or Regulation X that suggests this as a reason for withholding information. There is almost no useful case law on this question.[160] Given strong servicer resistance to making the NPV test public, it is a likely response to

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[155] 12 U.S.C. § 2605(e)(1)(B)(ii).

[156] 12 U.S.C. § 2605(e)(1)(A). *See also* 24 C.F.R. § 3500.21(e)(2)(i).

[157] For a discussion of what constitutes a QWR, *see* NCLC, *Foreclosures* § 8.2.2.2 (2d ed. 2007 and Supp.).

[158] 12 U.S.C. § 2605(e)(2)(C)(i); 24 C.F.R. § 3500.21(e)(3)(ii)(B).

[159] Supp. Dir. 09-01, 09-02, 09-03, 09-06, and 10-01 all include requirements relating to record keeping and documentation. Supp. Dir. 09-06 in particular lists many of the data fields that servicers must report to Fannie Mae. All NPV inputs and results are of course required, including the method of property valuation and the details of the modification considered (which may vary from the standard waterfall because of investor restrictions). Supplemental Directives 09-01 and 10-01 contain helpful minimum documentation requirements, including logs of individual borrower contacts, attempts to obtain waivers from investors, and training and policy materials.

[160] *See* Pettie v. Saxon, 2009 WL 1325947 (W.D. Wash. May 12, 2009) (accepting as in compliance with RESPA, without discussion, servicer's withholding of requested information with the explanation that it was privileged or confidential); *In re* Price, 403 B.R. 775 (Bankr. E.D. Ark. 2009) (finding that plaintiffs had stated a claim for relief under RESPA by alleging that information withheld by servicer was public record information reported to the SEC and would have identified specific loss mitigation and foreclosure avoidance measures available but not offered to plaintiffs).

QWRs and could get a boost from language in Supp. Dir. 09-08 which states that "[s]ervicers are not required to provide the numeric NPV results or NPV input values not enumerated in [the list of available data]." On the other hand, participation in the HAMP program clearly does not exempt servicers from otherwise applicable law and regulation. For instance, the Servicer Participation Agreement explicitly requires servicers to warrant that HAMP activities "will be performed in compliance with … Federal and state laws designed to prevent unfair, discriminatory or predatory lending practices." If RESPA would otherwise require disclosure of NPV information, contrary language in HAMP program documentation should be of little import.

Disputing a Wrongful HAMP Denial with a QWR

Another potential use of the QWR mechanism would be to request "correction" of a borrower's account in the form of a loan modification consistent with the HAMP guidelines. A threshold question is whether wrongful denial of a HAMP modification or incorrect application of the HAMP modification guidelines would constitute an account error within the meaning of RESPA. The statute and Regulation X do not specify the types of errors that borrowers may seek to correct.[161] Given that RESPA is a remedial consumer protection statute that should be construed liberally,[162] and that the handling of loss mitigation requests is a customary task of servicers in servicing mortgages, errors related to processing loan modification requests should be subject to the dispute procedures in RESPA.[163]

In the context of error correction, a QWR must include "a statement of the reasons for the belief of the borrower, to the extent applicable, that the account is in error."[164] Without knowing all the NPV inputs, it might be difficult for a borrower to make the necessary statement of reasons about why a HAMP denial was in error. Still, if the advocate has obtained some or all of the input values by either making a request under Supp. Dir. 09-08 or sending a QWR as described above, and it appears that HAMP eligibility was wrongfully denied, a follow-up QWR should be sent stating the reasons "to the extent applicable" why an account error has been made and requesting correction.

If the borrower requests correction of an account error, within 60 business days, the servicer must either: 1) correct the account and notify the consumer, or 2) conduct an

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[161] S*ee* NCLC, Foreclosures §§ 8.2.2.2, 8.2.2.5 (2d ed. 2007 and 2009 Supp.).
[162] Ploog v. HomeSide Lending, Inc., 209 F. Supp. 2d 863 (N.D. Ill. 2002) (holding RESPA is remedial in nature); Johnstone v. Bank of America, N.A., 173 F. Supp. 2d 815 (N.D. Ill. 2001) (same); Rawlings v. Dovenmuehle Mortgage, Inc., 64 F. Supp. 2d 1156 (M.D. Ala. 1999) (same).
[163] To the extent a borrower is charged late fees or penalties resulting from a delay in the conversion from Trial Plan to permanent modification or is charged any improper fees in relation to the modification, an even stronger argument can be made that the account should be "corrected." *See* 12 U.S.C. § 2605(e)(2)(A), defining correction of account to include crediting of late charges and penalties.
[164] 12 U.S.C. § 2605(e)(1)(B)(ii).

investigation and state the reasons why the account is correct, with the name and phone number of a servicer employee who can provide further information.[165]

Private Remedies Available

Sending a QWR does not stop the foreclosure process or collection efforts,[166] but if the servicer fails to respond appropriately, the borrower has a private right of action for actual (including emotional distress) damages, costs and attorney fees, as well as statutory damages up to $1,000 in the case of a pattern and practice of noncompliance.[167] Care should be taken in pleading your client's damages.[168]

Sending a QWR also protects a borrower's credit. Servicers cannot report adverse information on payments related to the subject of the QWR to consumer reporting agencies during the QWR response period.[169] This may be valuable in the HAMP context, because the borrower's mortgage remains in force during the Trial Plan Period and the reduced payments made by borrowers may be reported by servicers to credit bureaus as if they were partial payments.[170]

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[165] 12 U.S.C. § 2605(e)(2)(B).

[166] 24 C.F.R. § 3500.21(e)(4)(ii). This is arguably an overreaching interpretation by HUD of 12 U.S.C. § 2615, which provides that "validity and enforceability" of mortgages is not affected by RESPA.

[167] 12 U.S.C. § 2605(e). *See also* NCLC, Foreclosures § 8.2.6 (2d ed. 2007 and Supp.).

[168] Courts are increasingly requiring an allegation of actual damages as an element of a RESPA claim. *See* NCLC, Foreclosures § 8.2.6.2 (2d ed. 2007 and Supp.). This should not be insurmountable in the case of a HAMP wrongful denial. Even the failure to provide information could result in actual damages. For example, a borrower might argue that failure to provide the numerical NPV values resulted in the borrower throwing good money after bad trying to qualify for an unlikely HAMP modification when other loss mitigation options, such as a deed in lieu, would have been better for the borrower's finances and credit score.

[169] 12 U.S.C. § 2605(e)(3); 24 C.F.R. § 3500.21(e)(4)(i).

[170] The Consumer Data Industry Association has recently created a new reporting code for payments made under a HAMP Trial Plan. It is not clear whether reporting using the new code would qualify as providing "adverse information." HAMP FAQs, Q67.

REVERSE MORTGAGES CAN HELP SENIORS MEET THEIR FINANCIAL NEEDS

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Reverse Mortgages Can Help Seniors Meet Their Financial Needs, Estate Planning Journal, Sep 2009

REVERSE MORTGAGES

Reverse Mortgages Can Help Seniors Meet Their Financial Needs

As seniors continue to live longer and desire to age in place, they may wish to consider reverse mortgages as a financial alternative to help them fill in the gaps resulting from the uncertainty of other retirement investments.

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In today's troubled economic environment, estate and financial planners may want to consider several options to help seniors meet their financial needs. Reverse mortgages have become increasingly popular as a tool to supplement retirement income. Some lenders believe reverse mortgages will play a larger role in retirement planning as assets in retirement and investment accounts decline.

Since the inception of the federally insured reverse mortgage program known as the Home Equity Conversion Mortgage ("HECM") in 1989, the number of HECM loans made has grown dramatically. In 1990, a modest 234 HECM loans were made. This number swelled to 8,120 in 2001 and 115,176 in 2008. [1]

According to a recent study by the Employee Benefit Research Institute, 76% of workers expect to have the same or a higher standard of living when they retire, yet 50% of workers nearing retirement have less than $50,000 in savings and investments. Additionally, only 5% of current private sector workers have defined benefit pension plans versus 60% of such employees in 1980. [2] A reverse mortgage can be a useful tool to help seniors maintain their standard of living, keep their independence, stay financially fit, and cover routine or extraordinary expenses while living in the comfort of their own home.

What is a reverse mortgage?

A reverse mortgage loan can help seniors supplement their retirement income by tapping a portion of the equity in their home and turning it into funds that are generally tax-free. [3] After paying off any existing mortgages, funds can be applied toward medical care, home improvements, or other expenses.

Seniors are not required to make reverse mortgage payments for as long as they live in the home and retain an ownership interest. Borrowers can stay in the home for as long as they wish. When the loan becomes due following a termination event (discussed later), if the borrower, the heirs, or the estate wish to sell the home, they will never owe more than its appraised value. If the borrower or the estate

wishes to retain the property, the full loan balance must be repaid.

Background on reverse mortgages

Reverse mortgages have gone beyond a demonstration product to more of a mainstream loan. The most popular type of reverse mortgage is the federally-insured Home Equity Conversion Mortgage ("HECM"). This loan is insured by the Federal Housing Administration ("FHA"), a branch of the U.S. Department of Housing and Urban Development ("HUD"). HECMs account for the lion's share of all reverse mortgages made in the U.S. today.

Many reverse mortgage lenders have also developed proprietary products, which serve the purpose of a jumbo loan and can offer lower fees to the senior. However, the demand for proprietary products has declined significantly with the recent economic downturn. As the secondary market for proprietary reverse mortgages rebounds, and investor appetite for mortgage-backed securities strengthens, we expect to see a re-emergence of proprietary reverse mortgages. Until that time, most lenders will offer the HECM as their sole kind of reverse mortgage.

Over the past five to seven years, the FHA has worked diligently to improve the HECM program. This effort has resulted in a more innovative reverse mortgage that serves the needs of a broader population and offers seniors a tremendous amount of flexibility.

In October 2008, HUD took an important step to broaden the reach and accessibility of HECMs by creating a single national loan limit of $417,000 and by lowering the fees lenders are permitted to charge. Previously, an HECM loan carried substantial fees and relatively low, county-based loan limits, which topped out at $200,160 for the majority of counties and $362,790 for higher-cost areas. These changes enable existing HECM borrowers with higher home values to refinance and gain access to a greater amount of equity in their homes. In addition, seniors who have not obtained a reverse mortgage now have the opportunity to receive more money than was previously allowed.

The $787 billion American Recovery and Reinvestment Act signed by President Obama on 2/17/09 further raised the single national loan limit for an HECM to $625,500 for the rest of 2009. The provision, adopted by HUD, took effect on 2/24/09. This change allows even more seniors to receive additional funds through the refinancing of an existing reverse mortgage or through a new reverse mortgage loan. Reverse mortgage loan volume—both new and refinanced—has increased substantially for most lenders since the new limits became effective, demonstrating the demand for these loans and the benefit to seniors from these improvements.

Safeguards for borrowers

Reverse mortgages are widely regarded as a safe home loan for seniors because numerous measures on a national level are in place to ensure seniors' best interests are protected. The federal government has enacted a wide range of consumer protections for HECM reverse mortgages. Additionally, the National Reverse Mortgage Lenders Association ("NRMLA") was created to develop and promote best practices in the reverse mortgage industry.

Personal liability. Fundamentally, a reverse mortgage is a nonrecourse loan. If the borrower, his or her heirs or estate do not pay the loan balance when it becomes due, the lender is limited to the remedy of foreclosure, and the borrower, heirs or estate will not be liable for any deficiency resulting from the foreclosure.

Annuities. HUD provides strict guidelines and regulations for lenders to help protect borrowers from the marketing of financial and insurance products that are not in the best interest of the borrower, including the marketing or sale of an annuity as a condition of obtaining a reverse mortgage.

Third-party counseling. Before a borrower can obtain a reverse mortgage, he or she is required to speak

with an independent, third-party counselor who ensures that the borrower fully understands his or her options. There is a fee for counseling which may be paid at the time of counseling, or it may be financed with the loan.

How reverse mortgages work

To qualify for a reverse mortgage, applicants must be at least 62 years of age, and all borrowers must be titleholders of the property. If there is an existing mortgage balance on the home, it must be paid off or subordinated at the time of closing. Borrowers can choose to pay off the balance with funds from the reverse mortgage or another source. The amount of a reverse mortgage that a borrower can receive depends on several factors, including the age of the borrower(s), the appraised value of the home, and current interest rates. Generally, the more valuable the home and the older the borrower, the more the borrower can receive.

Payment options. A reverse mortgage borrower has the flexibility of choosing from the following five payment plans to receive the loan proceeds:

- *Tenure.* Under this payment plan, the borrower will receive equal monthly payments from the lender for as long as the borrower lives and continues to occupy the property as a principal residence.
- *Term.* Under this plan, the borrower will receive equal monthly payments from the lender for a fixed period of months selected by the borrower.
- *Line of credit.* This payment plan permits the borrower to receive the mortgage proceeds in unscheduled payments or in installments, at times and in amounts of the borrower's choosing, until the line of credit is exhausted.
- *Modified tenure.* Under this payment plan, the borrower may combine a line of credit with monthly payments for life, or for as long as the borrower continues to live in the home as a principal residence. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted.
- *Modified term.* This payment plan allows the borrower to combine a line of credit with monthly payments for a fixed period of months selected by the borrower. In exchange for reduced monthly payments, the borrower will set aside a specified amount of money for a line of credit, on which he or she can draw until the line of credit is exhausted. [4]

The borrower can change the payment option at any time for a nominal fee. The payment plan options and the ability to change them during the course of the loan provide a good opportunity for financial and estate planners and advisors to work with their senior clients to structure a reverse mortgage to fit the client's changing life circumstances.

How a reverse mortgage is paid back. With a reverse mortgage, borrowers do not have to make any payments as long as they live in their home and retain an ownership interest. There are several circumstances which cause the loan to mature and the balance to become due and payable. The most common reasons are: the last remaining borrower sells the home, moves to a nursing home, or dies. Other circumstances that may cause the loan to become due include the transfer of the title to another person or entity, failure to pay property taxes, failure to maintain and/or repair the home, or failure to keep the home insured.

Upon maturity of the loan, if the loan balance is *less* than the appraised home value or sale price, the borrower or the heirs owe only the loan balance. If the borrower sells the home, he or the heirs keep the difference between the appraised home value and the loan balance, less sales costs.

If the loan balance is *greater* than the appraised home value, the borrower or the heirs owe only the appraised home value or all proceeds from the sale. The borrower or the heirs may sell the home in order to pay the balance. The borrower or the heirs are not liable for any shortfall between the appraised home value and the loan balance.

If the borrower or the heirs wish to keep the property, the entire loan balance must be repaid. There are three basic ways a borrower or the heirs can pay off the balance of a reverse mortgage: (1) sell the home and use the proceeds from the sale, (2) refinance, or (3) use other sources of funding.

In any circumstance where the lender agrees to accept less than the full mortgage balance, the sale of the property by the borrower (or the borrower's estate) should be an arm's-length transaction. [5]

Borrower's responsibilities. With a reverse mortgage, the borrower still owns the home. This means the borrower is still responsible for the general maintenance and upkeep of the home. Additionally, borrowers are responsible for paying all ongoing property taxes, applicable flood insurance, and hazard insurance. They may use the proceeds from a reverse mortgage to help make these payments. It is important that the borrower keep taxes and insurance current because the loan may become due if taxes and insurance are not paid.

How reverse mortgages are used

A key benefit of reverse mortgages is the freedom borrowers have to use the funds however they choose. Many people choose a reverse mortgage to eliminate their monthly mortgage payments, and to cover large or unexpected expenses such as medical care, in-home care, or home repairs. In today's difficult economic environment, more and more seniors are using reverse mortgages to supplement their retirement income because of recent losses in other retirement investments.

Perhaps the biggest reverse mortgage benefit is the ability for seniors to age in place. They can enjoy financial security and maintain their independence, while staying in their home.

Identifying the right candidate for a reverse mortgage. Choosing a reverse mortgage is an important decision for borrowers and their families. It is important for borrowers to assess their current and future situation to determine their needs and goals, and then research all possible financial solutions.

Ideal candidates for a reverse mortgage are senior homeowners age 62 or older who do not have enough savings and investments to fund living expenses and who wish to age in place, as opposed to selling their home or moving. A reverse mortgage may also be right for those who are unable or unwilling to tap homeowner equity through a refinanced mortgage or home equity borrowing. Reverse mortgages are a useful financing option for seniors who want to remain in their home, be free of the burden of a mortgage payment, and have additional funds to supplement their retirement income.

It's important to understand situations in which a reverse mortgage may not be the best solution for a borrower. Seniors who are considering moving within a few years, who want to leave their home to their heirs free and clear, or are looking for funds to invest are typically not appropriate candidates for a reverse mortgage.

Opportunities for estate and financial planners

Reverse mortgages provide estate and financial planners with another tool to meet their clients' retirement needs. Advisors can have confidence in recommending a reverse mortgage as a safe, secure, and innovative way to supplement a client's retirement income and enable him or her to age in place. Reverse mortgages can be used (1) as a contingency plan for seniors whose retirement investments have declined, or (2) as a component of a financial plan for clients who have not yet reached retirement age.

The recent increases in reverse mortgage loan limits and the lowering of lender fees expand the reach of these loans to a broader client base and provide seniors with an opportunity for additional retirement income. Advisors can feel comfortable in assuring clients that reverse mortgages are safe because these loans provide several protections to ensure the best interest of the borrower. Clients will also appreciate the security of a government-insured and regulated loan.

Other pertinent details for practitioners. With any reverse mortgage, it is important to understand how a borrower's existing financial situation may be affected. A reverse mortgage may affect a borrower's tax status and/or eligibility for government aid programs. Moreover, a borrower's eligibility to participate in any real estate tax deferral program offered by his or her city or county may be affected.

Reverse mortgages do not affect government entitlement programs such as Medicare. However, certain needs-based government aid programs, such as Supplemental Security Income ("SSI") and Medicaid, may be affected. Borrowers should consult their Medicare, Social Security, or Medicaid administrator to determine the specific rules relating to SSI and reverse mortgages.

There are fees associated with reverse mortgages, many of which are similar to the fees a borrower would pay on a first mortgage, such as origination fees, closing costs, and mortgage insurance. All the fees can be financed with the loan, so borrowers will have no out-of-pocket expenses. Fees can vary, depending on which reverse mortgage product a borrower chooses. Exhibit 1 shows the typical costs associated with a government-insured HECM.

Future of reverse mortgages

As seniors continue to live longer and desire to age in place, many lenders believe the elderly will increasingly consider reverse mortgages as a financial alternative to help them fill in the gaps resulting from the uncertainty of other retirement investments. According to research by the American Association of Retired Persons ("AARP"), nearly 90% of seniors want to stay in their own homes as they age. Even if they begin to need day-to-day assistance or ongoing health care during retirement, most (82%) would prefer to stay in their homes. Additionally, 91% of pre-retirees age 50 to 65 want to live in their own homes in retirement. [6]

While a key driver of the current increase in popularity of reverse mortgages is the decline in borrowers' assets, these loans are likely to move beyond simply a needs-based product or product of last resort, and become an important component of the holistic retirement planning process.

Resources for more information. For additional information on reverse mortgages, practitioners may wish to visit the following websites:

- Bank of America, www.bankofamerica.com.
- National Reverse Mortgage Lenders Association ("NRMLA"), www.nrmla.org.
- U.S. Department of Housing and Urban Development ("HUD"), www.hud.gov.

PRACTICE NOTES

A reverse mortgage can help seniors supplement their retirement income by tapping a portion of the equity in their home and turning it into funds that are generally tax-free.

Exhibit 1. Fees for a Reverse Mortgage

Fee Type	Description	Home Equity Conversion Mortgage (`HECM')
Origination Fee	A fee paid at origination that covers operating expenses to set up the loan.	Greater of $2500 or 2% of initial $200,000 maximum claim amount and 1% on the balance thereafter, with a cap of $6,000.
Closing Costs	Fees paid at origination that include all third-party vendor costs; closing costs	Standard closing costs apply.

	may include an appraisal, title search, flood certification, and title and hazard insurance.	
Servicing Fee	A fee used to cover the cost of servicing the loan; costs may include monthly statements, insurance and tax verification, periodic property maintenance inspections and processing your withdrawals and other requests.	Up to $35 per month.
Mortgage Insurance	The borrower will be charged mortgage insurance premiums (`MIP') to reduce the risk of loss in the event that the outstanding balance, including accrued interest, MIP and fees, exceeds the value of the property interest when the mortgage is due and payable.	2% of the maximum claim amount is charged at closing, and a .5% fee is included in the rate.
Counseling Fee	A fee paid to a third-party independent counseling agency.	$125.

1

See U.S. Department of Housing and Urban Development ("HUD"), HECM Endorsement Summary Reports, www.hud.gov/pub/chums/f17fvc/hecm.cfm.

2

Source: Center for Retirement Research at Boston College.

3

Borrowers should consult their tax advisor for questions regarding potential tax implications.

4

See HUD, Handbook 4235.1, Chapter 1, 1-5 PAYMENT PLAN, www.hud.gov/offices/adm/hudclips/handbooks/hsgh/4235.1/42351c1HSGH.doc.

5

An arm's-length transaction is characterized by the following: (1) the absence of a relationship between the buyer and seller; (2) a selling price and other conditions that would prevail in an open market; (3) transaction costs paid by the seller that are reasonable and customary for the market in which the property is located; and (4) the adherence to ethical standards of conduct by all parties involved in the HECM short sale transaction, including the borrowers (or the estate), mortgagees and appraisers. See HUD, MORTGAGEE LETTER 2008-38, www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/08-38ml.doc.

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REVERSE MORTGAGES

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American Bankruptcy Institute
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July 9, 2010

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REVERSE MORTGAGES AND HECM'S

- Home Equity Conversion Mortgage (HECM)
- FHA has federally insured program started in 1989
- HECM is a reverse mortgage insured by FHA
- 2009 more than 114,000 HECM's made

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PROPRIETARY REVERSE MORTGAGES

- Many lenders have their own reverse mortgage programs
- Offer lower fees (ex. no origination fee and no servicing fee)
- Demand lower for these types of mortgages

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BENEFITS OF REVERSE MORTGAGES

- 50% of workers nearing retirement have less than $50,000 savings
- 5% of private sector workers have pension plans
- Reverse mortgages help seniors maintain standard of living, keep independence and stay in their homes

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REVERSE MORTGAGES ARE NOT FOR

- Seniors who want to move in a few years
- Seniors who want to leave unencumbered home to heirs (no mortgage to pay)
- Seniors looking for funds to invest

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REVERSE MORTGAGE FACTS

- Borrower must be 62 or over and own home
- Single family or 1- to 4-family principal residence
- No principal and interest payments
- Borrower must pay taxes, insurance and utilities
- Can affect tax status or eligibility for government aid

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REVERSE MORTGAGE FACTS

- Lender considers property value, not ability to pay to determine loan amount
- Lender considers value of property and age of borrower; the older the borrower, the less risk for lender
- Loan fees usually 5% of home's value
- Borrower has choice of payment options

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REPAYING THE REVERSE MORTGAGE

- No payments while borrower lives in and owns home
- Loan matures when borrower sells, moves to nursing home or dies
- On maturity, lender entitled to loan balance only
- If property value less than payoff, lender gets only sale proceeds

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HECM CHANGES

- 2008 - HUD placed new limits on loan fees
- HUD rules require use of property value to determine benefits for borrower
- Maximum dollars available based on these factors (1) age of youngest borrower, (2) estimated interest rate over loan term if adjustable rate, or actual rate if fixed rate, and value of property
- Can use reverse mortgage to purchase residence

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HECM COMPLIANCE

- Numerous FHA Mortgagee Letters published in 2009 and 2010
- 4/10 FHA Final Rule on increased capital requirements for FHA approved lenders from $250,000 net worth to $1 million net worth
- New limitations on appraisals for FHA mortgages

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HECM PROTECTIONS FOR SENIORS

- Non-recourse loan
- Lender limited to foreclosure
- Neither borrower, heirs or estate liable for deficiency

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HECM PROTECTIONS FOR SENIORS

- Limitations on marketing financial and insurance products
- Borrower must participate in free pre-loan counseling with 3rd party counselor
- Counseling charges cap at $125, but maybe free depending on counseling agency chosen
- Disclosure requirements

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STATE LAWS - MASSACHUSETTS

- M.G.L. c. 167E (banks); M.G.L. c. 171 (credit unions)
- Massachusetts Division of Banks must approve programs
- Changes pending in S.2394 will require in-person counseling by Executive Office of Elder Affairs

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STATE LAWS – RHODE ISLAND

- R.I.G.L. §34-25.1 effective January 1, 2009
- Same protections as HECM's
- Prepayment penalties only if lender waives fees
- 3-day right of rescission
- Penalties where lender fails to make required disbursements
- Advances can't be reduced due to interest rate changes

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STATE LAWS – NEW HAMPSHIRE

- N.H. Rev. Stat. Ann. 397-A:15 amended in 2009 to add Sections VIII and XI
- Section VII prohibits yield spread premiums paid to brokers in connection with reverse mortgages (does not apply to bank brokers)
- Section XI prohibits loan brokers or lenders from being associated with or employing party who is involved in another financial or insurance activity
- Also prohibits lender from obligating borrower to purchase financial or insurance product as a condition for getting reverse mortgage

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STATE LAWS – MAINE

- Me. Rev. Stat. Ann. Title § 8-206-B (1995)
- Requires disclosure of fees and costs 3 days prior to closing
- Must advise borrower not obligated to close just because disclosure received or application signed
- Rules on determining projected total cost of reverse mortgage

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STATE LAWS – VERMONT

- Vt. Stat. Ann. Title 8 § 10701 (2009)
- Vt. Stat. Ann. Title 8 § 10702 (2009)
- Vt. Stat. Ann. Title 8 § 10703 (2009)
- Vt. Stat. Ann. Title 8 § 10704 (2009)
- Requires in-person pre-loan counseling by a HUD –approved counselor
- Can't condition the loan on annuity
- Loan must be a HUD HECM

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STATE LAWS CONNECTICUT

- No specific Connecticut state law on reverse mortgages
- Connecticut Housing Finance Authority (CHFA) makes reverse mortgages known as Reverse Annuity Mortgages (RAM) to limited-income homeowners with chronic health problems and long-term care needs, but does not strictly limit how money can be used.

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STATE LAWS

- New Maryland law passed May 2010 (effective October 1, 2010)
- New Arizona law passed April 2010

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REVERSE MORTGAGE FRAUD

RECENT ATLANTA CASE

- Two Defendants pleaded guilty 4/8/10
- Could face up to 30 years in prison and fines exceeding $1 million
- Defendants used stolen real estate broker passwords to go on MLS to create fake property listings and property sales at inflated prices

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REVERSE MORTGAGE FRAUD

- Fake HUD-1 settlement statements used to document sale of seniors' non-existent assets
- Defendants faked required down payments for purchase money reverse mortgages using bogus gift letters from "relatives" of borrowers; funds actually came from defendants and were returned on closing to defendants along with substantial profits from reverse mortgage loan proceeds

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REVERSE MORTGAGE FRAUD

CROSS SELLING

- Theft of senior's reverse mortgage loan proceeds through cross-selling of financial or insurance products in violation of HUD rules or state law
- Loan officers convince seniors to use loan proceeds to finance purchase of expensive and unnecessary insurance, annuities, etc.

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REVERSE MORTGAGE FRAUD

CASH-OUT THEFT

- Theft of loan proceeds by individuals trusted by senior
- Trusted individuals can be family members, care takers and loan officers
- Senior is persuaded to apply for and close on reverse mortgage

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REVERSE MORTGAGE FRAUD

PROPERTY FLIPPING

- Straw buyer transfers low-value or problem property to unsuspecting senior. Fraudsters instruct senior to apply for reverse mortgage using an overstated appraisal or fraudsters assume identity of senior and apply themselves

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REVERSE MORTGAGE FRAUD

DISTRESSED NON-SENIOR MORTGAGORS

- Seniors sometimes asked to take out a reverse mortgage for others in financial trouble
- Some distressed mortgagors submit fraudulent paperwork and receive loan proceeds directly
- Fraudsters may assume senior's identity and take out mortgage without senior's knowledge

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REVERSE MORTGAGE FRAUD

POWERS OF ATTORNEY

- Can be used in schemes above
- Senior does not have full knowledge about loan being applied for
- POA may be used for either seller or buyer

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REVERSE MORTGAGES AND BANKRUPTCY

- *In re Wilcox,* 209 BR 181 (Bankcy E.D.N.Y. 1996)
- *In re Carter,* 2009 Bankr. LEXIS 4201 (Bankcy S.D.Texas 2009)
- *In re Lena Boudreaux*, 2010 Bankr. LEXIS 777 (Bankcy E.D.La. 2010)

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