College of Law

Professor Katherine Porter
431 Boyd Law Building
Iowa City, Iowa 52242-1113
319-335-7490
Fax 319-335-9098

Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?

Written Testimony
of

Katherine Porter
Associate Professor
University of Iowa College of Law

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Subcommittee on Administrative Oversight and the Courts

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Witness Background

I am an Associate Professor of Law at the University of Iowa College of Law.[1] I joined the faculty in 2005. I received my J.D. degree *magna cum laude* from Harvard Law School and my B.A. degree *cum laude* from Yale College. I teach bankruptcy, commercial law, and consumer law and have published empirical research on consumer credit in several respected journals, including the *Michigan Law Review*, the *Cornell Law Review*, the *Wisconsin Law Review*, and the *American Bankruptcy Law Journal*.[2] I have testified several times before committees of the U.S. House of Representatives on consumer protection issues.

With Tara Twomey, I am a co-investigator in the Mortgage Study, a national empirical study of mortgages in consumer bankruptcy cases. I served as Project Director of the 2001 Consumer Bankruptcy Project and am one of the principal investigators in the ongoing 2007 Consumer Bankruptcy Project. My current research examines the issues facing homeowners in bankruptcy and mortgage servicing practices both inside and outside the bankruptcy system.

I have not received any federal grants or contracts relevant to this testimony.

Introduction

For many families, their greatest financial fear is losing their home to foreclosure. A home is not only most families' largest asset but also a tangible marker of their financial aspirations and middle-class status. A threatened or pending foreclosure can signal the end of a family's ability to struggle against financial collapse and an unrecoverable tumble down the socioeconomic ladder.

Mortgage servicers are the parties responsible for collecting payments from homeowners and taking action if a homeowner defaults. Thus, mortgage servicers play a crucial role in the homeownership process. My testimony explains why mortgage servicers lack incentives to obey the law and to charge consumers only what is owed. These troublesome incentives impose risks on all homeowners.

The reliability of mortgage servicing worsens in bankruptcy. While bankruptcy is supposed to offer families one last chance to save their homes from foreclosure,[3] the reality is that bankruptcy gives mortgage servicers new opportunities to engage in abusive practices. My study of 1700 bankruptcy cases showed that mortgage lenders routinely disobey clear rules of bankruptcy law and attempt to collect thousands more dollars than consumers believe is owed. These findings, along with dozens of published cases from bankruptcy courts, highlight how mortgage servicers' current practices permit them to impose unwarranted fees without scrutiny or sanction.

The existing system does not ensure that borrowers pay only what is due under the terms of their mortgage notes. Instead, mortgage servicers can and do take advantage of struggling homeowners. Such misbehavior can cripple a family's efforts at homeownership. Without improved laws and enforcement activity, homeowners in financial trouble—both inside and outside bankruptcy—remain vulnerable to mortgage servicers' misbehaviors and mistakes. The costs of such abuse are devastating: families wrongfully lose their homes, the number of foreclosures is driven upward, and the integrity of the legal system is undermined.

Incentives for Abusive Mortgage Servicing

Mortgage servicers act as intermediaries between borrowers and owners of mortgage notes. Servicers' responsibilities are set out in a pooling and servicing agreement and include collecting payments from borrowers and disbursing those payments to the appropriate parties

such as lenders, investors, taxing authorities, and insurers.[4] The participation of servicers complicates the borrower-lender relationship.

Mortgage servicers do not have a customer relationship with homeowners; they work for the investors who own the mortgage-backed securities or the note itself.[5] Borrowers cannot shop for a loan based on the quality of the servicing, and they cannot change servicers if they are dissatisfied with the servicers' conduct.[6] Indeed, it appears that servicers fail to satisfy customers. A study found that only 10% of borrowers are happy with their mortgage servicer.[7] Because their customers are the investors in large pools of mortgage loans, servicers have few reputational or financial incentives to provide decent customer service to homeowners.[8]

In fact, servicers have a financial incentive to impose additional fees on consumers. Mortgage servicers earn revenue in three major ways. First, they receive a fixed fee for each loan. Typical arrangements pay servicers between .25% and 1.375% of the note principal for each loan.[9] Second, servicers earn "float" income from accrued interest between when consumers pay and when those funds are remitted to investors. Third, servicers usually are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay.[10] A significant fraction of servicers' total revenue comes from retained fee income.[11] In this way, a borrower's default can boost a servicer's profits.[12] Because of this structure, servicers' incentives upon default may not align with investors' incentives.[13] Servicers have incentives to make it difficult for consumers to cure defaults, rather to engage in loss mitigation.

A consumer is only obligated to pay charges if the charges are permitted by the terms of the mortgage and by state and federal law. To validate such charges, consumers must know how the servicer calculated the amount due and whether such fees are consistent with their loan contract. A lending industry representative has admitted that "[m]ost people don't understand the most basic things about their mortgage payment."[14] Mortgage servicers can exploit consumers' difficulty in recognizing errors or overcharges by failing to provide comprehensible or complete information. In fact, poor service to consumers can actually maximize servicers' profits.[15]

Spiking foreclosure rates may exacerbate problems with mortgage servicing.[16] Cash-strapped lenders have fewer resources to devote to loan servicing, and the costs of servicing non-performing loans (such as those in default or foreclosure) are many times higher than servicing performing loans. Just as more borrowers risk losing their homes, servicers may have to lay off employees, skimp on procedural safeguards, or reduce investment in technology. These pressures reduce the likelihood that servicers have the staffing and technology to handle loan modifications and employ careful procedures that protect the rights of consumers.[17] Mortgage servicing is a crucial part of the homeownership process that must be part of any response to the rising foreclosure rate.[18]

Mortgage Servicing Abuse – All Homeowners

Any homebuyer can be a victim of abusive or illegal mortgage servicing. The documented instances of misbehavior are not limited to situations when a family files bankruptcy.[19] The most common abuses that are not specific to bankruptcy are:

- Servicers or lenders taking enforcement action (such as filing a foreclosure) when they do not own the loan or have the right to do so
- Imposing unwarranted or illegal fees on consumers (such as charging for force-placed insurance when a homeowner has provided proof of insurance)
- Miscalculating the amount owing (such as the amount needed to cure a default)

- Failing to provide homeowners with information (such as an itemization of charges)[20]

Two cases illustrate the harms of abusive servicing. In *Rawlings v. Dovenmuehle Mortgage, Inc.*,[21] the servicer repeatedly asserted that the homeowner had failed to make payments, imposed late fees, and sent notices of default. The consumer spent over seven months to resolve the servicers' errors in applying the payments to the wrong account. In another instance, borrowers refinanced their home loan, but their prior servicer continued to threaten to foreclose on their home and to report adverse information to credit bureaus.[22] The *Boston Globe* reported on one specific way that mortgage companies frequently overcharge consumers. The servicers typically include projected foreclosure costs in loan payoff amounts given to borrowers in default.[23] These fees are estimates for anticipated services that will not be incurred if the borrower does in fact refinance or cure the default. While a consumer advocate described the practice as a "license to steal from homeowners," an industry representative conceded that it was "pretty much industry standard."[24]

Abusive servicing can push a homeowner into default or can make it impossible for a homeowner to climb out of trouble. Research has shown that the quality of loan servicing can affect the incidence of loan default.[25] Just as preventive servicing can reduce loss severities, abusive servicing can heighten them.[26] As long as mortgage servicing remains unregulated, families remain at risk of being overcharged or wrongfully losing their home.

Mortgage Servicing Abuse – Families in Bankruptcy

Most consumers who file Chapter 13 bankruptcy cases are homeowners.[27] A bankruptcy filing halts a pending foreclosure and gives families the right under federal law to cure any defaults on mortgage loans over a period of years. I conducted an empirical study of the actions of mortgage servicers in bankruptcy cases that found that mortgage servicers disregard bankruptcy law in more than half of all cases.[28] Rather than being a refuge for families trying to save their homes, bankruptcy creates new opportunities for mortgage servicing abuse. The following are common examples of abusive mortgage servicing in bankruptcy cases:

- Failing to document the purported debt or to attach the required documentation to claims
- Filing motions for relief from the bankruptcy stay to proceed with foreclosure when the debtor is actually current on payments
- Misapplying payments received during the bankruptcy case (i.e., applying the bankruptcy plan payments that are intended to cure the arrearage to new charges so the debtor does not reduce the default or applying the ongoing payments to arrearage amounts so that the debtor appears to be in default on the current month's payment)
- Double-counting escrow amounts by including them in the arrearage amount and in the calculation of the amount of ongoing payments
- Violating the bankruptcy rules regarding the disclosure of attorneys fees
- Imposing default charges such as appraisals during bankruptcy despite the confirmation of a bankruptcy plan to cure the arrearages or continuing to impose such charges even after the debtor has cured the default
- Failing to disclose postbankruptcy fees or costs to debtors, trustees or bankruptcy courts
- Disregarding the escrow calculation and disclosure requirement of the Real Estate Settlement Procedures Act during the bankruptcy case

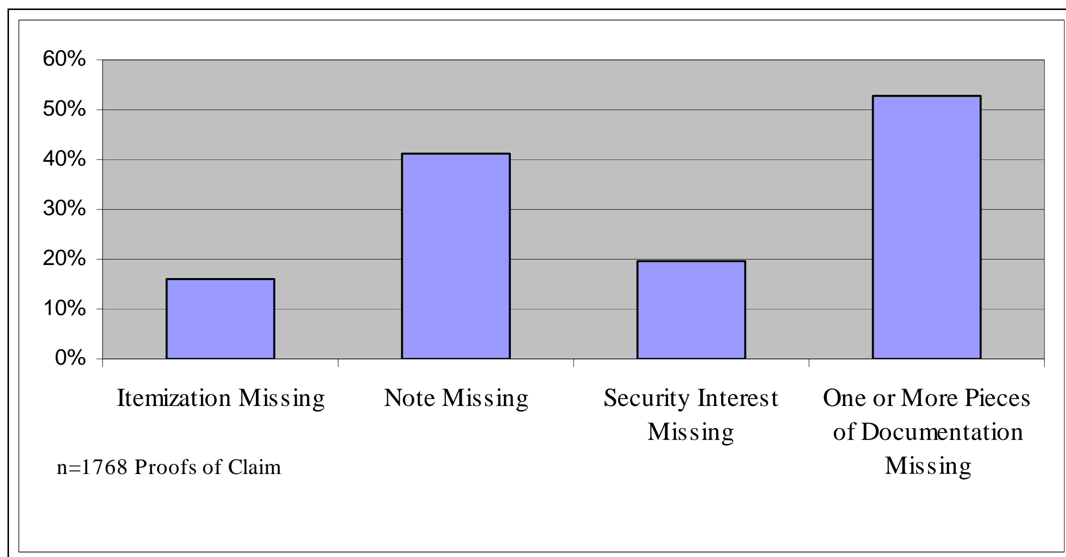
- Attempting to foreclose after a debtor receives a bankruptcy discharge despite the debtor properly making all payments during the bankruptcy plan

Each of these practices has been exposed in litigation in bankruptcy courts, but continues to occur despite court rulings that such activity is unlawful. The upsetting reality is that the current bankruptcy system routinely forces borrowers to pay bloated amounts and permits mortgage servicers to misbehave without serious consequence. This situation significantly threatens bankruptcy's purpose of helping families save their homes.

My study examined the proofs of claims that mortgage companies filed in 1733 Chapter 13 bankruptcy cases filed in April 2006 from across the nation. The purpose of a proof of claim is to establish the amount of a debt. Bankrupt debtors must pay mortgagees' claims or lose their homes. Unambiguous federal rules designed to protect homeowners and to ensure the integrity of the bankruptcy process obligate the mortgage company to disclose information accurately.[29] To ensure the accuracy and legality of such claims, the law requires three pieces of document action to be attached to a mortgage claim: a copy of the promissory note,[30] a copy of the recorded mortgage,[31] and an itemization of any interest or fees included in the debt.[32] Without documentation, parties cannot verify that the debt is correctly calculated and reflects only amounts due under the terms of the note and mortgage and permitted by law.

Yet, mortgage companies fail to comply with these basic requirements more than half of the time. A majority of claims (52.77%) lacked one or more required attachments as shown in the graph below. This finding strongly suggests that poor mortgage servicing in bankruptcy is not limited to one or two entities; it is the industry norm.

Percent of Proofs of Claim Missing Required Documentation



This pattern of noncompliance undermines the purpose of the bankruptcy rules. Undocumented or insufficiently documented claims create obstacles to ensuring that mortgage creditors are paid in accordance with the law. At worst, creditors' failure to provide documentation can manipulate the bankruptcy system to overpay on these obligations, harming the debtor and all other creditors.[33] By obscuring the information needed to determine the alleged basis for the charges, servicers thwart effective review of mortgage claims. Their blatant

disregard for the clear rules of the bankruptcy system effectively shifts the burden to debtors, trustees, or courts to request documentation or to engage in costly litigation to verify the accuracy of the purported debt. The bankruptcy system can only function as intended if complete and appropriate disclosures are made. The data show that in a majority of instances mortgage servicers flaunt such duties in bankruptcy cases.

My study highlighted further problems with mortgage claims. Specifically, I measured how frequently mortgage servicers attempted to collect fees or costs without identifying such charges. Despite using the servicing industry's own categories to clarify the fees that I examined,[34] 43% of mortgage claims either made reference to fees that did not fit one of the categories or proffered an aggregate sum of many types of charges. Some amounts were labeled merely "other" or included in a column of summed figures with absolutely no description at all.[35] After individually reviewing all claims with such fees, I identified dozens and dozens of fees that appeared to be impermissible, or at minimum, should have been challenged to ensure that the creditor had a basis for such unusual charges. The table gives a few examples of suspicious fees.

Actual Fees from Mortgage Claims

Description	**Id. No.**	**Fee amount**
Attorney's fees	WDVA 4	$31,273
Bankruptcy fees & costs	NDGA 56	$2275
Broker price opinion fee	ED AR 18	$1489
Demand fee	DMA 18	$145
Overnight delivery	EDMI 91	$137
Payoff statement fee	SDCA 7	$60
Fax fee	EDVA 21	$50

On their face, these fees are vulnerable to legal challenge. The law constrains the charges that borrowers must pay in several ways, including the terms of the note, applicable state law, and the Bankruptcy Code. Yet, none of these claims were objected to by any party in the bankruptcy. The various legal limits on fees were never invoked to test the validity of these charges.

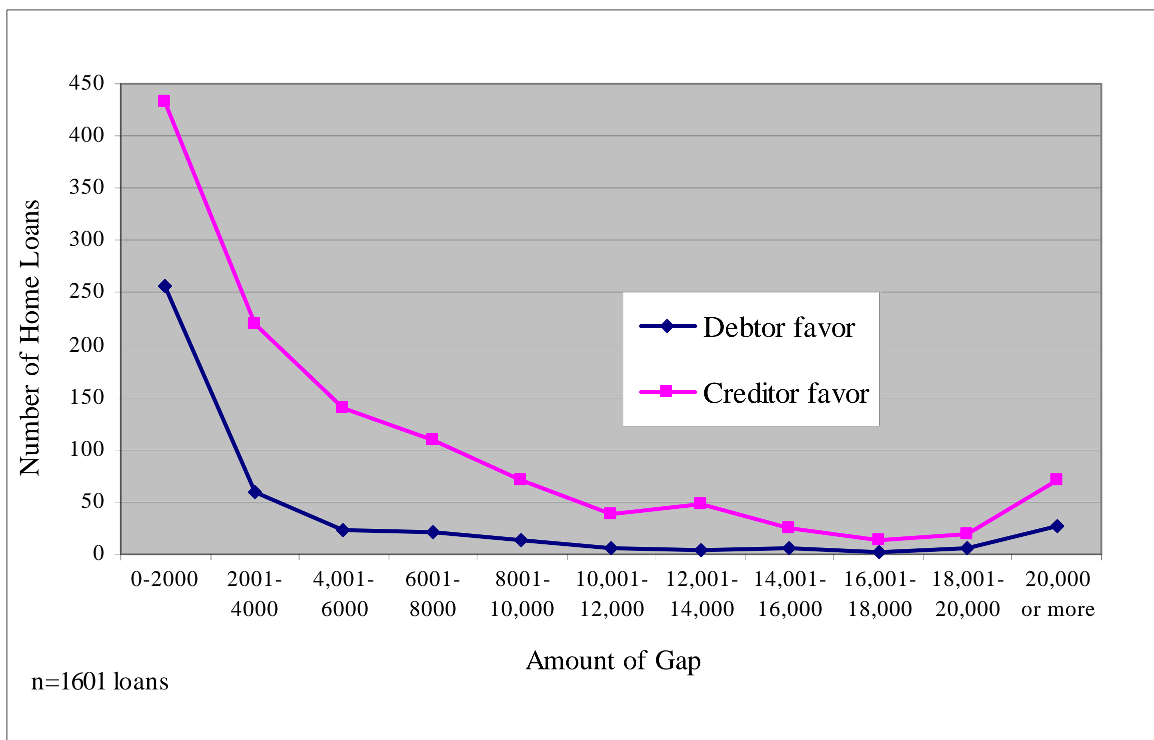
In the rare instances when courts do scrutinize the nature of mortgage claims, they frequently find evidence of servicer misbehavior. For example, Wells Fargo recently was faulted for charging a debtor for a broker price opinion, a form of appraisal, after it had completed the foreclosure and the debtor no longer owned the home. The same debtor was charged for broker price opinions allegedly conducted in Jefferson Parish, New Orleans while that area was under an evacuation order and closed to all but emergency personnel.[36] In another case, a court found that Countrywide charged a debtor for its attorneys fees incurred in filing an inaccurate and unwarranted motion for relief from the bankruptcy stay, even though it proclaimed to have an unwritten policy against such charges.[37] In yet another case, a court found that a servicer "repeatedly fabricated the amount of the Debtor's obligation to it out of thin air," alleging that "the Debtor owed it $48,691.36 *less* than what it demanded of the Debtor in April of 1998 and $192,963.64 *more* than it demanded of her on July 13, 1999."[38]

My study examined whether debtors and creditors agree on the amount of the mortgage debt. For this analysis, I matched each home loan listed on a particular debtor's bankruptcy schedule to the loan's corresponding proof of claim. I then measured the direction and extent of the gap between debtors' and mortgagees' calculations of the mortgage debt. For the vast majority of loans (95.6%), the debtor and mortgagee did not agree on the amount of mortgage debt. In about one-quarter of instances (25.2%), the debtor's scheduled amount exceeded the mortgagee's claim (a "debtor's favor" gap). However, the majority of claims filed by mortgage companies exceeded the debtor's calculation ("creditor's favor" gaps). Seven in ten (70.4%) claims asserted that the mortgage debt was greater than the debtor believed was owed.

Analysis of the dollar size of the discrepancies in debtors' and mortgagees' records suggests that these disagreements are genuine and serious. Among all loans, the median claim exceeded its corresponding scheduled debt by $1366. The average difference between a claim and its scheduled debt was $3533. In the typical bankruptcy, a mortgage creditor tried to collect a much larger debt than the debtor expected. These errors are too large to reflect small recordkeeping situations, such as a single late charge imposed since the debtor's most recent mortgage statement or a post-bankruptcy property inspection.

Very large gaps were much more common when the creditor's calculation exceeded the debtor's calculation. Many creditors requested payment on the proof of claim of several thousand more dollars than debtors thought they owed, as shown in the graph below. In the average instance when the mortgage creditor tried to collect more than the debtor expected (creditor's favor gaps), the discrepancy was $6309. For struggling families in bankruptcy, this is a formidable amount. Faced with these high debts, many families may be unable to confirm a bankruptcy plan and may lose their homes to foreclosure.

Gap Between Proofs of Claim and Schedule D Amounts



The current bankruptcy process is malfunctioning. The data on missing documentation, unsubstantiated fees, and discrepancies in recordkeeping, combined with the growing body of case law sanctioning mortgage servicers for their conduct in bankruptcy cases, raise the specter that many bankrupt families are being overcharged. Despite these problems, mortgage creditors are rarely called to task for their misbehavior. Objections were identified to correspond with only 67 of the 1768 proofs of claim in my study (4% of all claims). Debtors, trustees, and other parties simply do not object to mortgagees' claims—even when such claims do not meet the standard for prima facie validity; even when such claims contained vague or suspicious fees; and even when such claims exceeded the debtors' calculation of the debt by thousands of dollars. While Congress has emphasized the importance of a reliable bankruptcy system that garners the public's trust, mortgage servicers face no meaningful consequences when they disregard the law.

Protecting Homeowners and Restoring Integrity to the System

Mortgagees' failure to respect bankruptcy law is not a mere technicality. The bankruptcy rules and procedures were implemented to prevent substantive harm to debtors, to all creditors collectively, and to the integrity of the court system. Allowing mortgage servicers to "opt-out" at will of the bankruptcy law undermines the rule of law and the public's confidence in the bankruptcy system. Such misbehavior also undermines bankruptcy's core purpose of helping financially-distressed families save their homes, and when it occurs outside of bankruptcy, can force a family into foreclosure.

The evidence that unreliable mortgage servicing is pervasive suggests that legal reforms are needed. While I believe that most servicing abuses in bankruptcy violate existing law,[39] the reality is that current provisions are not sufficiently strong to generate compliance from mortgage servicers. An effective legal system requires more than merely putting words into law or relying on silence as an indication of acceptable and just behavior. I identify several modest reforms that would create effective enforcement mechanisms for industry compliance, restoring integrity to the bankruptcy process and protecting struggling homeowners.

The first problem to address is mortgagees' failure to provide adequate documentation and information to borrowers, trustees, and courts. While the bankruptcy rules about documentation to claims use mandatory language, phrased in terms of "shall,"[40] the reality is that in a majority of instances, these rules are ignored. The consequences of disregarding Rule 3001 need to be sharpened. The simplest solution is to revise section 502(b) of the Bankruptcy Code to include the failure to provide the attached documentation as a basis for claims disallowance. This reform would ratchet up the consequences for failing to provide a note or security interest to support the amount owed. In effect, a creditor who could not validate the existence of the purported debt with evidence could not receive more in bankruptcy than it would have been entitled to had it been put to its proof in a judicial-foreclosure lawsuit. In this way, the bankruptcy process would be at least as rigorous as the foreclosure scheme outside of the federal system. This is not a radical proposal; it simply would clarify existing law that creditors should only be paid what is actually owed to them.

An additional strategy is to squarely impose the burden of reviewing mortgage claims on trustees. The Bankruptcy Code already states that a trustee shall "if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper."[41] The U.S. Trustee Program should mandate the review of mortgage claims as an official duty of trustees in their program handbook, and trustees should be evaluated on their fulfillment of this duty.[42] If the Chapter 13 trustees find serious or systematic misconduct, the problems should be referred to

the U.S. Trustee for enforcement activity. The U.S. Trustee has taken a positive step in this direction by becoming involved in litigation over alleged wrongdoing by mortgage servicing. While mortgage servicers have attempted to characterize these actions as overreaching, the legislative history shows that Congress' primary goal for the U.S. Trustee office was for it to serve as a "watchdog over the bankruptcy process."[43] I encourage the members of this Committee to express their support for the U.S. Trustee's office fulfilling this obligation by challenging egregious or widespread abuse of the bankruptcy process by creditors.

A complementary tactic to these enforcement strategies would be to improve the procedures for disclosing fees. A model itemization for proofs of claims was promulgated by a committee of mortgage industry representatives and Chapter 13 trustees and mortgage servicers.[44] The model form would require servicers to provide details such as the type of the loan, its interest rate, and any payment adjustment dates. It also sets out a standardized format for servicers to break out the amount of any pre-petition arrearages, categorize each charge, and report how many times each type of charge had been imposed. The Advisory Committee on Bankruptcy Rules should incorporate the model form into the bankruptcy rules. Voluntary adoption by mortgage servicers is highly unlikely, if not wholly implausible. To date, no servicer has adopted these forms, despite five years of industry participation in their development. Without changes to section 502 of the Bankruptcy Code, without strengthening the duties on trustees, and without improving the bankruptcy rules forms, mortgage servicing will continue to threaten struggling families and the reliability of the bankruptcy process.

Under current law, mortgage servicers impose post-bankruptcy fees and costs on debtors but do not disclose these charges to debtors, trustees, or the courts. This practice results in families making all payments under their bankruptcy plan and then upon discharge being hit with hundreds or thousands of dollars in additional fees that allegedly accrued during the bankruptcy case. Unable to meet such a burden, some families find themselves facing foreclosure right after bankruptcy or needing to file a successive bankruptcy case. The Bankruptcy Code should be amended to require the disclosure of post-bankruptcy fees and costs on either a current, real-time basis when the servicer wishes to impose the fees or on at least an annual basis. These disclosures should be filed with the bankruptcy court and sent to the debtor and the trustee, both of whom would be given an opportunity to object if the fees appear to be without merit. To ensure adequate incentives to review these disclosures, the law should require mortgage servicers to pay the attorneys' fees and court costs of successful challenges to the legality of these post-bankruptcy fees. If a mortgage servicer fails to disclose post-bankruptcy fees, such charges should be deemed to be waived and unenforceable as a matter of law, regardless of the outcome of the debtor's bankruptcy case.

The addition of section 524(i) to the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 is proving inadequate to correct the widespread failure of creditors to properly credit payments received under a Chapter 13 bankruptcy plan. As an initial matter, the word "willful" should be removed from the statute. The creditor has a duty under the mortgage contract and bankruptcy law to comply with court orders governing the case. The debtor should not need to show anything other than that the creditor did, in fact, fail to do so by improperly crediting the payments. The more substantive problem with section 524(i) is some courts are limiting its applicability to actions brought after a debtor has received a bankruptcy discharge. Such a reading allows mortgage servicers to misapply payments during the pendency of a bankruptcy case—forcing the debtor to incur additional charges and interest and to suffer motions for relief from the stay to resume foreclosure—and then to avoid any consequence for

misapplying the payments when the servicer's own misbehavior forces the debtor to drop out of bankruptcy before receiving a discharge. While I creditors are already obligated to follow a confirmed plan because it is a court order, it would greatly strengthen enforcement activity with regard to misapplication of plan payments if a parallel to section 524(i) was added to the Bankruptcy Code to address the misapplication of payments before or regardless of discharge. This statute should entitle a debtor or trustee to damages and attorneys' fees if she proves that a creditor failed to properly credit payments. This ensures that debtors are protected from the severe harms of misapplied plan payments during the pendency of their cases and after discharge.

In bankruptcy, mortgage servicers have attempted to evade their obligations under the Real Estate Settlement Procedures Act ("RESPA") to provide homeowners with information. RESPA can be a powerful tool to address servicing abuse if minor changes are made. First, Congress should enact language similar to that in H.R. 5679, the Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, to clarify the scope of information that servicers must provide in response to a qualified written request, to prohibit imposing a fee on a homeowner who makes such a request, and to require mortgage servicers to provide consumers with an address to which qualified written requests may be sent.[45] These changes would help all homeowners, not just bankruptcy debtors. Second, RESPA should be amended to clarify that when a bankruptcy case is pending, the trustee in a debtor's case has the same rights and standing as the debtor to make qualified written requests and to assert any actions against the servicer for violating RESPA. Third, the Department of Housing and Urban Development (HUD) should eliminate its rule that servicers are not required to perform an annual escrow analysis for loans in default or bankruptcy.[46] The RESPA regulations should also make clear that the duty to provide a notification of a shortage or deficiency in escrow continues during bankruptcy cases. The current rule is perverse; struggling homeowners have an even greater need than performing borrowers to be aware of any increases in their payments and to understand the amount of their mortgage debt. In those bankruptcy cases when a trustee is making the ongoing mortgage payment, the trustee needs to be alerted to changes in escrow payments in order to adjust the payment stream and prevent the debtor from exiting bankruptcy with a deficiency. Finally, RESPA should be amended to create a private right of action for the failure to provide an annual escrow statement or to send a notice of shortage or deficiency to ensure the law is not a hallow promise.

Industry representatives may suggest that congressional action is unnecessary because agencies have the authority to regulate mortgage servicing. This argument is specious. Although forty percent of consumer complaints to HUD apparently concern servicing issues,[47] HUD does not routinely investigate these complaints or collect data from servicers on compliance issues. Indeed, when HUD has acted, it has worsened the situation with regard to bankruptcy cases, as noted above. Fannie Mae and Freddie Mac's promulgated servicing guidelines have in some also instances worsened the quality of servicing in bankruptcy cases.[48] For example, the guidelines merely tell servicers to file a proof of claim using a "suitable" form;[49] the result of this vague instruction is widespread disregard for the documentation requirements for claims. Due to their market share, Fannie Mae and Freddie Mac could substantially reduce the problems with servicing in bankruptcy cases if they monitored their servicers' performance in complying with the proof of claim rules and the application of payments.

Servicers may also argue that mortgage servicers intend to comply with the law and are trying to improve their procedures. Even assuming the truth of these assertions, the reality is that

such changes will come too late for millions of families in foreclosure and hundreds of thousands of families who have filed Chapter 13 bankruptcy to save their homes. The industry has had ample warning about its servicing problems. In addition to the release of my study in October 2007, servicers have faced litigation from the U.S. Trustee alleging a pattern or practice of inappropriate conduct and have had a dozen courts expose their wrongdoings, some of whom imposed sanctions[50] or have required that they improve their practices.[51] Yet, even in the face of such attacks, the mortgage servicers have refused to improve their technology, staff, and procedures for homeowners in bankruptcy. Congressional action is required. The past year has shown that no other entity—neither debtors, nor debtors' attorneys, nor panel/standing trustees, nor the U.S. Trustee Program, nor the bankruptcy courts—is willing and able to address the assault of abusive mortgage servicing on homeownership and the bankruptcy system.

Conclusion

Hundreds of thousands of Americans file bankruptcy each year hoping to save their homes from foreclosure. My empirical research shows that many mortgagees fail to comply with applicable law in bankruptcy cases, leaving debtors at risk of being overcharged or losing their homes. Verifying that debtors only pay amounts to which creditors are legally entitled should be a routine part of bankruptcy process. Current law fails to offer sufficient incentives and enforcement tools to curb mortgage servicing abuse. As a result, mortgage companies operate under an assumption that their behavior only rarely will be reviewed or challenged. Alarmingly, the problems with mortgagees' calculations may be even worse outside of bankruptcy, where the rules are less clear and the procedural safeguards are fewer. Yet, the reality is that most defaults and foreclosures occur outside the bankruptcy system.[52] Systematic reform of the mortgage servicing industry is needed to protect all homeowners—inside and outside of bankruptcy—from illegal behavior.

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[1] Additional biographical information and my curriculum vitae are available at my faculty page at the University of Iowa College of Law at http://www.law.uiowa.edu/faculty/katie-porter.php.

[2] My research papers may be downloaded from my SSRN author page at http://ssrn.com/author=509479.

[3] Raisa Bahchieva, Susan Wachter & Elizabeth Warren, *Mortgage Debt, Bankruptcy, and the Sustainability of Homeownership*, in CREDIT MARKETS FOR THE POOR 73 (Patrick Bolton & Howard Rosenthal eds., 2005) (stating that Chapter 13 bankruptcy is frequently used by families who face foreclosure).

[4] Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POLICY DEBATE 753, 755 (2004).

[5] Some lenders retain the servicing obligations after they make loans, but the active market for securitization and servicing contracts means that very few customers will have their loan serviced by the originating lender.

[6] Jack Guttentag, *Why is Mortgage Servicing So Bad?*, http://www.mtgprofessor.com/A%20-%20Servicing/why_is_servicing_so_bad.htm (Feb. 3, 2003; updated Dec. 13, 2004).

[7] Press Release, J.D. Powers and Associates, *Customer Service and Attention to Detail Drive Home Mortgage Satisfaction* (Nov. 26, 2002), http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2002144.

[8] Id.

[9] NAT'L CONSUMER LAW CENTER, FORECLOSURES 23 (2006 Supp.).

[10] Eggert, *supra* note 4, at 758 (explaining that servicers' conventional fee is a percentage of the total value of the loan but that servicers typically have the right to retain any default fees).

[11] Some information can be gleaned from the securities filings of public companies that service mortgages. Late charges account for approximately 11% of revenues for Ocwen's residential mortgage servicing division in 2006. *See* Ocwen Financial Corp., Annual Report (Form 10-K), at 30 (Mar. 16, 2007).

[12] NAT'L CONSUMER LAW CENTER, *supra* note 9.

[13] Statement of Sheila C. Bair, Testimony before U.S. House Comm. on Financial Services at 9, (April 17, 2007).

[14] Lenders Look for Way to Avoid Bankruptcy Maze, NAT'L MORTGAGE NEWS, Aug. 30, 2004.

[15] Guttentag, *supra* note 6.

[16] Posting of Tara Twomey, Subprime Servicing Getting Worse, to *Credit Slips* blog, http://www.creditslips.org/creditslips/2007/03/subprime_servic.html (Mar. 19, 2007).
[17] Kurt Eggert, *Comment: What Prevents Loan Modifications*, 18 HOUSING POLICY DEBATE NO. 2 (2007) (documenting barriers that servicers face in loan modifications).
[18] Congresswoman Waters has introduced legislation to require servicers to engage in loss mitigation activity before beginning foreclosure and to prohibit them from charging excess fees. *See* H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, 110th Cong. (2008).
[19] Fed'l Trade Comm'n, Mortgage Servicing: Making Sure Your Payments Count, *at* http://www.ftc.gov/bcp/conline/pubs/homes/mortgserv.htm.
[20] *See, e.g.*, *See* Gretchen Morgenson, *Can These Mortgages Be Saved?* N.Y. TIMES (Sept. 30, 2007) (reporting that a payoff demand statement that Countrywide provided to a borrower had line items identified only as "fees due" and "additional fees and costs" that totaled $8525); S.P. Dinnen, *Mortgage Complaints Can Take Extra Effort*, DES MOINES REGISTER, May 2, 2004; A. Pesquera, Paper Trail of Problems: Some Fairbanks Clients Report Nightmare Errors, SAN ANTONIO EXPRESS-NEWS, Aug. 9, 2002.
[21] 64 F. Supp. 2d 1156 (M.D. Ala. 1999).
[22] *Islam v. Option One Mortgage Corp.,* 432 F. Supp. 2d 181 (D. Mass. 2006).
[23] Sacha Pfeiffer, *Hidden Legal Fees Push Some Into Foreclosure*, BOSTON GLOBE (Jan. 18, 2007).
[24] *Id.*
[25] Anthony Pennington-Cross & Giang Ho, *Loan Servicer Heterogeneity &The Termination of Subprime Mortgages*, Federal Reserve Bank of St. Louis Working Paper No. 2006-024A (April 2006), *at* http://research.stlouisfed.org/wp/2006/2006-024.pdf (finding that individual servicer affected chance of default to substantial degree among large sample of subprime mortgages).
[26] Michael A. Stegman, et. al., *Preventive Servicing Is Good for Business and Affordable Homeownership Policy*, 18 HOUSING POLICY DEBATE 243 (2007).
[27] TERESA SULLIVAN, ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT, 202 (2000) (half of all bankruptcy debtors are homeowners); Bahchieva, Wachter & Warren., *supra* note 3, at 104–05 (explaining that homeowners disproportionately choose Chapter 13 because Chapter 7 does not protect home equity).
[28] *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims* (forthcoming 83 TEX. L. REV. 2008), http://ssrn.com/abstract=1027961.
[29] *See, e.g.*, *In re* Matus, 303 B.R. 660, 675 (Bankr. N.D. Ga. 2004) ("The [bankruptcy] statutes are designed to insure complete, truthful and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction.").
[30] Fed. R. Bankr. P. 3001(c) ("When a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim.").
[31] Fed. R. Bankr. P. 3001(d) ("If a security interest in property of the debtor is claimed, the proof of claim shall be accompanied by evidence that the security interest has been perfected.").
[32] Official Form 10, *available at* http://www.uscourts.gov/bankform/formb10new.pdf.
[33] *See* Opinion Resolving Show Cause Order Entered on March 8, 2007, *In re* Wingerter, No. 06-50120 (Oct. 1, 2007) ("A policy of filing a proof of claim without having possession of the supporting documents, but withdrawing the claim if the debtor subsequently files an objection to the claim's validity smacks of gamesmanship and creates an unacceptable risk that distributions to other creditors will be unfairly reduced.")
[34] The categories used to code the fees are those developed by a joint committee of Chapter 13 trustees and mortgage servicers. *See* Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (on file with author).
[35] For example, one claim's "itemization" listed $5391 described only as "other." (CDCA 12). Another claim requested $3023 for "delinquency expenses." (NDGA 146).
[36] *In re Stewart*, No. 07-1113 at 27-28 (Bankr. E.D. La. April 10, 2008)
[37] *See In re Parsley*, 05-90374 at 29-30 (Bankr. S.D. Tex. Mar. 5, 2008). The court documented other inappropriate fees that were included in the proof of claim at pp. 41-44 of its opinion.
[38] Maxwell v. Fairbanks Capital Corp. (*In re* Maxwell), 281 B.R. 101, 114 (Bankr. D. Mass. 2002).
[39] For example, a confirmed chapter 13 plan is an order of a bankruptcy court. A parties' disregard of that order could be punished under a court's equitable powers. Similarly, an attempt to collect money that is not owed under the contract violates Federal Rule of Bankruptcy Procedure, which requires that legal pleadings have factual and legal support and not be filed for an improper purpose. Sanctions are permitted for Rule 9011 violations.

[40] Fed. R. Bankr. P. 3001(c) and (d).
[41] 11 U.S.C. § 704(a)(5).
[42] Currently, any trustees apparently believe that no purpose would be served by objecting to claims without the documentation required by law. For example, while notes were missing from forty percent of claims in my study, trustees filed only one or two objections that raised that issue.
[43] House Report No. 989, 95th Cong., 2d Sess. at 88 (reprinted in 1978 U.S. Code Congressional & Admin. News at 5787, 5963, 6049).
[44] Model Proof of Claim Attachment, NAT'L ASS'N OF CHAPTER THIRTEEN TRUSTEES, REPORT OF MORTGAGE COMMITTEE (June 28, 2007) (manuscript on file with author). The model attachment would also require the creditor to provide the MERS Number for the loan, the real property tax number and parcel number, and a contact person for the servicer (not just the servicer's attorney).
[45] *See* H.R. 5679, The Foreclosure Prevention and Sound Mortgage Servicing Act of 2008, 110th Cong. (2008).
[46] 24 C.F.R. 3500(i)(2).
[47] Guttentag, *supra* note 6
[48] For example, Fannie Mae's referral system for bankruptcy cases often meant that debtors were charged twice for attorneys to review their file—once for a foreclosure attorney and then again when the case was referred to a bankruptcy attorney. Also, if servicers used a bankruptcy network attorney, they were excused from monitoring the attorney's performance. Fannie Mae discontinued the program in 2007. *See* Fannie Mae Announcement 07-09 (July 18, 2007), https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2007/0709.pdf
[49] *See* Fannie Mae Single Family 2006 Servicing Guide, section 402.08.
[50] *See*, *e.g., Nosek v. Ameriquest Mortgage Company, et al., (In re Nosek)* No. 02-46024, Adv. Nos. 04-04517 and 07-4109 (Bankr. D. Mass. April 25, 2008) (imposing monetary sanctions on Ameriquest, Wells Fargo, and several attorneys for misrepresenting the holder of the note)
[51] *See, e.g.,*In re Stewart, No. 07-1113 (Bankr. E.D. La. April 10, 2008) (awarding damages and legal fees and sanctioning Wells Fargo for the abusive and negligent imposition of fees, and moreover, ordering Wells Fargo to conduct an audit of every proof of claim filed on its behalf in cases pending on or after April 13, 2007).
[52] Foreclosure filings appear to outnumber bankruptcy cases filed by homeowners by a ratio of four to one. In 2006, there were 597,965 non-business bankruptcy filings, s*ee* Administrative Office of the U.S. Courts, *Bankruptcy Filings Plunge in Calendar Year 2006* (Apr. 26, 2007), *at* http://www.uscourts.gov/Press_Releases/bankruptcyfilings041607.html. The best available data, the 2001 Consumer Bankruptcy Project, indicate that about 52.5% of all families in bankruptcy are homeowners. *See* Bahchieva, Wachter & Warren, *supra* note 3, at 92. Accordingly about 300,000 bankruptcy cases were filed by homeowners. In the same year (2006), there were 1,259,118 foreclosure filings. *See* RealtyTrac, *More Than 1.2 Million Foreclosure Filings Reported in 2006* (Jan. 25, 2007), *at* http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=1855&accnt=64847. *See also* Dennis R. Capozza and Thomas A. Thomson, *Subprime Transitions: Lingering or Malingering in Default?* 33 J. OF REAL EST. FIN. & ECON. 241–58 (2006) (reporting that only 11% of subprime borrowers in default by 90 days or more subsequently filed bankruptcy in the preceding eight months).