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POLICING LENDERS AND PROTECTING HOMEOWNERS: IS MISCONDUCT IN BANKRUPTCY FUELING THE FORECLOSURE CRISIS?

HEARING

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

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POLICING LENDERS AND PROTECTING HOMEOWNERS: IS MISCONDUCT IN BANKRUPTCY FUELING THE FORECLOSURE CRISIS?

TUESDAY, MAY 6, 2008

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2:09 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Charles E. Schumer, Chairman of the Subcommittee, presiding.

Present: Senators Schumer, Feingold, Whitehouse, and Sessions.

OPENING STATEMENT OF HON. CHARLES E. SCHUMER, A U.S. SENATOR FROM THE STATE OF NEW YORK

Chairman SCHUMER. The hearing will come to order.

Over the past year, we have heard much about the questionable lending practices that have harmed homeowners, roiled Wall Street, and stalled the economy, especially the ways that greedy lenders preyed on borrowers with subprime loans that many did not understand and could not afford.

What is far less known is the way that unscrupulous mortgage lenders and servicers have mistreated some of those same borrowers a second time when they are down and out and at their most vulnerable—in bankruptcy. There is a disturbing pattern of piling on that we need to get to the bottom of.

So today I want to pull back the curtain on a hidden corner of the mortgage crisis. As bankruptcies swell and defaults rise and revenue streams dry up, I feel a vulture mentality is developing in some quarters, and that vulture mentality threatens to turn the dream of homeownership into an even worse nightmare than it has been for many already.

For instance, a homeowner is down on her luck and is forced to file for bankruptcy. She successfully completes a repayment plan to keep her home through Chapter 13 protection. There has been on foreclosure because she has rationally tried to keep her home through a Chapter 13 workout. That is what Chapter 13 is all about. But then she receives word that she owes more money on her mortgage than on the day she filed for bankruptcy, or she has to fight off foreclosure even though she has been making payments like clockwork.

How does this happen? How are these companies able to prey on homeowners with such impunity? As Professor Porter, who is a wit-

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ness here today, has meticulously documented, they do it through a maze of dubious and undocumented fees. All too often these charges are inflated, duplicative, or made up. Just as often they are undocumented, undisclosed, or just plain awful. They include late fees, demand fees, overnight delivery fees, fax fees, payoff statement fees, property inspection fees, and legal service fees. This is death by a thousand fees.

And the companies know that the hapless homeowner is too poor, too unsophisticated, or too overwhelmed to challenge often blatantly fraudulent demands for payment. Lest anyone think we are exaggerating the problem, consider the record.

As Judge Joel B. Rosenthal has noted, an increasing number of lenders "in their rush to foreclosure, haphazardly fail to comply with even the most basic legal requirements of the bankruptcy system."

The catalogue of alleged misconduct is too long to list in full detail here. But companies have repeatedly sought to foreclose on homes where owners were current in their payments, sought attorneys' fees in bankruptcy court for motions that they have lost, and failed to keep even the most basic records to justify their claims in bankruptcy court.

Consider some of the stories that are, unfortunately, becoming routine in this lesser known corner of the subprime crisis. In the case of Sharon Diane Hill in Pittsburgh, Countrywide has admitted fabricating documents to wring dubious payments from a homeowner in bankruptcy. Judge Thomas P. Agresti had this to say about Countrywide's alleged fabrication of letters: "These letters are a smoking gun that something is not right in the state of Denmark." It is a mixed metaphor, admittedly, but it makes the point.

In the case of Robin and John Atchley, Countrywide twice wrongly tried to foreclose on their home when they were actually current on their payments. In that case, the regional trustee for the Atlanta area wrote in a brief that, "Countrywide's failure to ensure the accuracy of its pleadings and accounts in the Atchley case is not an isolated incident."

Indeed, Countrywide today says problems exist in only a small number, maybe 1 percent of their cases. That would be if it is 1 percent of their cases, which is what they claim, it would be about 650 of the 65,000 cases Countrywide has in bankruptcy. But even a cursory look at court records seems to tell a different story, a dramatically different story. In just one judicial district alone, the Western District of Pennsylvania, the trustee is so concerned, he is looking at 300 cases involving trouble with Countrywide. If there are 300 potential cases in Pittsburgh, it is hard to believe there are only 650 nationwide. So given that fact alone, the 1-percent number seems dubious, to say the least.

But, of course, the questionable behavior is by no means limited to Countrywide. Unfortunately, it seems dubious practices span the loan servicing industry. Consider the case of Jacqueline Nozick in Massachusetts who desperately tried to save her home by diligently paying off her debts over 5 years in Chapter 13. But Ameriquest, the company servicing her loan, botched receipt of her payments so badly, they ruined her credit and made it impossible for her to refinance. Said Mrs. Nozick of how she was treated, "I felt like somebody hit me in the stomach and, you know, sucker punched me. I became tremendously depressed, and really since then I haven't been able to get my feet under me." The court agreed with that assessment and sanctioned Ameriquest to the tune of $500,000 in punitive damages and $250,000 for emotional distress.

In the case of Pearl Maxwell, an 83-year-old Massachusetts woman with limited education, Fairbanks Capital Corporation took advantage of her by repeatedly demanding payments from her that she did not owe. The bankruptcy court lambasted the company's conduct, calling it "egregious and inexcusable."

In another case in the Northern District of Texas, a company filed a proof of claim that it was owed more than $1 million when the principal balance on the note was only $60,000.

The list goes on and on, and the bad behavior is not even limited to mortgage companies. Law firms, unscrupulous law firms, have also gotten into the act. For instance, one Federal bankruptcy judge has criticized what he called "a corrosive assembly line culture of practicing law." And another bankruptcy judge had this to say: "Above all else, what kind of culture condones its lawyers' lying to the court and then retreating to the office hoping that the court will forget about the whole matter."

We invited a law firm to testify about its practices, but it refused, claiming overbroadly that the attorney-client privilege prevented its appearance.

Well, I hope today we can begin to get to the bottom of this practice of piling on. To be sure, there is some good news. The United States Trustee Program has launched a series of investigations into these practices, as we will hear about today. Judges are finally starting to hold the firms accountable, and now Congress will indeed play its part. My message to unscrupulous lenders and servicers should be heard loud and clear. Congress will no longer countenance this vulture mentality. We will not stand for the continued abuse of homeowners who have worked hard and played by the rules of bankruptcy, only to have their homes and credit ratings and livelihoods threatened by misconduct at the hand of greedy corporations who made poor bets in the first place.

Given the record, I think the burden has shifted to these mortgage companies to demonstrate that their bad practices do not form an intentional pattern or a deliberate business strategy. There are too many horror stories, too many investigations, too many sanctions imposed for us to simply take the word of a company spokesman that "mistakes were made" and they were few in number. We need a thorough and public accounting of industry practices.

And let me make a point about Countrywide here. I have always wondered why Bank of America, a fine institution with a good reputation, was willing to purchase Countrywide given its recent history. And I understand that there has been encouragement by the financial regulators to make this transaction happen. These latest revelations should make Bank of America think even harder about how they want to proceed with the deal. If it turns out that the purchase price for Countrywide was based in part on profits from thee bad practices, Bank of America should demand a lower price because these practices will not—will not—be allowed to continue.

As we go forward, we will look closely at any and all solutions to these problems. Do we need better deterrence, stiffer penalties, more robust disclosures? We will consider any and all such options, and I look forward to hearing from our witnesses.

[The prepared statement of Senator Schumer appears as a submission for the record.]

I now recognize Senator Sessions for an opening statement.

STATEMENT OF HON. JEFF SESSIONS, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator SESSIONS. Thank you, Senator Schumer.

The bankruptcy court is a Federal court. We created the legislative framework under which those courts operate, and I think we have a responsibility as the United States Congress to examine how it is working, to identify problems and fix those problems, and I think your hearing today gives us an opportunity to, like you said, go into some of these areas that a lot of people are not aware of but that are very important. If you are yourself a victim of a false claim or an unjustified motion for relief from stay and we do not—I mean, it is not enough to say "I am sorry" once you get caught. Something needs to be done about it.

I guess my question would be, as we go forward—and I look forward to hearing from our panels—is: What are we doing to discipline those who violate these standards if we have a substantial amount of it? The law requires that they file the requisite documents as a part of the proof of claim. If that is routinely not being done, why isn't, first, the lawyer for the grantor, the person—the debtor, why shouldn't they complain first? Second, why aren't the trustees being more aggressive in filing? Why are not the bankruptcy judges lacking people who do that? And if they do that consistently and set a clear standard of behavior for the attorneys that appear before them in court, officers of the court, I think we will have a lot less of this. And to the extent to which this is an ongoing and widespread problem, I believe a lot of it can be fixed by leadership from the judge to the trustee to the lawyers who are supposed to be representing the interests of the poor person.

Thank you. I look forward to hearing from our witnesses.

Chairman SCHUMER. Great. Thank you, Senator Sessions, and thank you for your settlement.

We are now going to undergo the formality of swearing all the witnesses in, so will you please rise, each of you, and raise your right hand? Do you affirm that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. BAILEY. I do.

Ms. MILLER. I do.

Ms. PORTER. I do.

Ms. ATCHLEY. I do.

Mr. WHITE. I do.

Chairman SCHUMER. Thank you. You may be seated. We have four witnesses here, and I would like to introduce each one, and then we will hear from each of them.

Steve Bailey is a Senior Managing Director for Loan Administration at Countrywide Financial Corporation. In that capacity, Mr.

Bailey is responsible for overseeing Countrywide's loan servicing operations.

Debra Miller is a Standing Chapter 13 Trustee for the Northern District of Indiana, serving Federal courts in Fort Wayne and South Bend. She is Treasurer of the National Association of Chapter 13 Trustees, and earlier in her career she was a special agent for the United States Secret Service in Cleveland, where she specialized in credit card and white-collar fraud.

Associate Professor Katherine M. Porter teaches bankruptcy, commercial, and consumer law at the University of Iowa. Her current research examines mortgage claims and consumer bankruptcies. Professor Porter, I note that Senator Grassley, who is very proud of his Iowa Hawkeyes, is tied up at the conference on the farm bill now, but wanted to be here to greet you and introduce you personally. He may be able to do that later. He sends his regards.

And, finally, Mrs. Robin Atchley is a letter carrier from Ballground, Georgia. She will speak with us today about some of the issues she faced with her bankruptcy in 2005.

The entire statements of each witness will be read into the record. Mr. Bailey, you may proceed.

STATEMENT OF STEVE BAILEY, SENIOR MANAGING DIRECTOR, LOAN ADMINISTRATION, COUNTRYWIDE FINANCIAL CORPORATION, SIMI VALLEY, CALIFORNIA

Mr. BAILEY. Thank you, Chairman Schumer and Ranking Member Sessions, for the opportunity to speak with you today regarding bankruptcy servicing and foreclosures. Countrywide is committed to helping our borrowers avoid foreclosure whenever they have a reasonable source of income and a desire to remain in the property.

The goal of a Chapter 13 bankruptcy is to provide borrowers with a fresh start and an opportunity to retain their most valued asset—their home. A successful Chapter 13 plan is in everyone's interest—the borrower, the investor, and the mortgage servicers. Countrywide has always strived to accurately report and reflect the amounts due from borrowers so they can complete their bankruptcy plans and avoid foreclosure altogether.

Today, I will focus on recent enhancements we have made to our bankruptcy processing and discuss the new initiatives that focus on three objectives: transparency, accuracy, and integrity.

Before I discuss these initiatives, I would like to highlight some of the challenges servicers face in the bankruptcy process. Most borrowers who file for Chapter 13 bankruptcy are hoping to establish a repayment plan that allows them to repay their pre-petition debts and avoid foreclosure. Once in a plan, borrowers are also required to stay current on their post-petition mortgage obligations. Unfortunately, there are times when borrowers fall behind and make partial payments. The uneven flow of payments causes servicers to incur further fees and costs.

For example, when a borrower falls substantially behind, the servicer retains an attorney to file a motion for relief from bankruptcy stay. We strive to be flexible and extend opportunities to borrowers to bring their payments current. At the same time, however, the servicer has a duty to honor its contractual obligations to the mortgage holder or the investor.

Bankruptcy servicing is further complicated by widely disparate rules that vary significantly across many bankruptcy jurisdictions. As a result, it is by necessity a human process in which mistakes are sometimes made. We strive to minimize these errors, and a number of internal reviews indicates that Countrywide has an error rate of less than 1 percent from mistakes that adversely impact the borrower. In addition, our policies and practices are designed to avoid incurring fees in accounts that are in bankruptcy.

For example, Countrywide does not charge late fees on post-petition delinquencies. We also do not collect pre- payment penalties for loans that pay off while in bankruptcy. In general, Countrywide does not initiate motions for relief from stay until the debtors are 45 to 60 days past the due date on their post-petition plan.

Countrywide is committed to further reducing the potential for individual employee errors, however, and we have implemented a number of changes to improve this process. To increase the transparency of charges to the borrower, we provide allowable notices and escrow account analyses to keep borrowers accurately informed of their payment status. To improve accuracy, we created a validation team to review each proof of claim, each motion for relief of stay, and other documents to be filed in the bankruptcy court. This team also provides an audit of each loan after the bankruptcy case is over.

Finally, to ensure the integrity of our bankruptcy servicing, we announced today a three-point plan to validate our processes and assure continuous improvement.

First, we will retain a qualified independent auditor to review a statistically significant sample of randomly selected loans in bankruptcy going back 3 years. The examination will focus on the accuracy of our bankruptcy accounting for pre- and post-petition payments. It will also review the accuracy and pleadings filed in the bankruptcy matters. If the audit identifies mistakes, affected borrowers will be compensated or their accounts adjusted. Once completed, we will work with the auditor to determine whether additional enhancements are necessary to improve our processes.

Second, we will establish the Bankruptcy Ombudsman Office to provide a means for borrowers to initiate a high-level review of their bankruptcy servicing records if they believe that they have been improperly charged or adversely affected by processing errors. The Ombudsman Office will research individual matters and will make appropriate refunds or account adjustments caused by errors on our part.

Third, we have reviewed the National Association of Chapter 13 Trustees' current best practices, and we agree completely in principle. We are only averse to a few practices that might be legally or contractually impermissible or that would increase costs to customers. In fact, just recently, in talking with Ms. Miller here, I believe that that will be easier to achieve than even initially assumed, that some of these things have already been worked out.

As you may know, we are in discussions also with the U.S. Trustee's Office regarding a resolution to a number of specific bankruptcy cases. Those discussions are ongoing, and we hope that this three-point plan will help us to move even closer to a resolution.

Thank you.

[The prepared statement of Mr. Bailey appears as a submission for the record.]

Chairman SCHUMER. Ms. Miller. Trustee Miller.

STATEMENT OF DEBRA MILLER, STANDING CHAPTER 13 TRUSTEE, NORTHERN DISTRICT OF INDIANA, SOUTH BEND, INDIANA

Ms. MILLER. Thank you, Senator Schumer and Senator Sessions, for the ability to come and speak to you today.

Chapter 13 Trustees have a unique role in the bankruptcy process. We act as mediators and arbiters, and we make sure that everybody plays fair and by the rules to maintain the systemic integrity of the bankruptcy system. Because of this, the trustees have been aware of the systemic problems and abuses of the mortgage servicers for years. In fact, about 4 years ago, my court actually directed our office to personally contact each servicer before the end of the bankruptcy to ensure that the debtor was contractually current, that there were no outstanding fees, costs, or negative escrows that could harm them after the discharge.

One example that I wanted to bring was we have a case that I actually administer, and the gentleman is a trucker. For various reasons, he became behind on his mortgage payments and was facing foreclosure. He chose to file a Chapter 13 bankruptcy to save his house for him, his wife, and his two children and to reorganize his debts. For 5 years, he made every payment on time to my office, and we in turn paid the mortgage company every time, on time, each month. We cured his mortgage arrearage. We caught up what he was behind, and we paid 100 cents on the dollar to every unsecured creditor.

Imagine the surprise of my office when we contacted the mortgage servicer last year and the servicer claimed that this debtor was now $3,900 behind on his mortgage payment. And I just want to note that that was three times more than he was behind when he actually filed the bankruptcy.

When we contacted the servicer, we provided our payment records. We found mis-posted payments. We found fees, costs, and charges that had been added to his account. And when we tried to resolve it and brought this matter before the judge, the mortgage servicer actually alleged in court that we as trustees had no ability to challenge their actions in the bankruptcy court and the court had no jurisdiction over them.

Because of these types of continuing issues, groups of trustees, servicers, and servicer attorneys met in 2003, and we continue to meet today. Through that group and the collaboration, we have begun to open the lines of communication and draft goals as to how mortgages should actually be serviced while they are in a Chapter 13.

I wanted to note that the servicer frustration that came loud and clear to us as trustees was that they felt that they were unable to comply with the myriad of different rules and cases in the bankruptcy courts, and they wanted to find a national solution to that issue so that they could do the same thing in Indiana as they could in Alabama and they could in California.

Through the work of the group, we actually drafted best practices as to how those mortgages should be serviced. They have been drafted. They have been revised. They have been shared by the judges and also with the debtors' attorneys. And I should note that the people on our committee include large servicers, small servicers, prime servicers that actually service prime loans and subprime loans. And it also includes their attorneys and the judges in the advisory capacity.

But, unfortunately, these best practices are voluntary, and the servicers have been slow to adopt the best practices. These goals and best practices have been in place for 2 years, and I can tell you that not a single servicer at this time is complying with the best practices. I do know that there are two servicers who are currently—they advise me that they are in the process of putting them in place.

Congress and this Subcommittee have the ability to solve this problem, and we believe that the best practices are actually the solution to solve that problem. This would require enacting legislation to require the mortgage companies to file notices of payment changes, of fees and costs, and it would require enacting legislation clearly giving the bankruptcy court the authority to review these post-petition costs and fees for reasonableness. It would require an amendment to the Real Estate Settlement Procedures Act to make sure that the debtor, debtor's attorney, and trustee were given the information on escrow changes, and it would also require in that same act to make clear that the servicer could provide the annual statement to the debtor without violating the automatic stay.

Last, we believe that the GSEs, Fannie Mae and Freddie Mac, in their regulations should require the servicers that actually service the Freddie and Fannie loans to only be servicers that actually comply with the best practices. I believe that enacting this legislation and the best practices will solve the issue, and we would be pleased to work with this Subcommittee to draft the appropriate legislation to make this happen.

In closing, I really appreciate that the Subcommittee is looking into this issue. We will need to get this resolved for the debtors, and I would be pleased to answer any questions that you or the members of the Subcommittee might have.

[The prepared statement of Ms. Miller appears as a submission for the record.]

Chairman SCHUMER. Thank you, Trustee Miller.

Professor Porter?

STATEMENT OF KATHERINE M. PORTER, ASSOCIATE PROFESSOR, THE UNIVERSITY OF IOWA COLLEGE OF LAW, IOWA CITY, IOWA

Ms. PORTER. Chairman Schumer, Ranking Member Sessions, and members of the Committee, I am deeply grateful for your interest in addressing the serious problems with mortgage servicing that affect millions of struggling homeowners and harm the integrity of the banking system. Mortgage servicers lack sufficient incentives to obey the law and to charge consumers only what is owed. Indeed, servicers have a financial incentive to impose additional fees on consumers or to bloat the costs of services to build in profit for themselves. Poor mortgage servicing can maximize servicers' profits even as it harms homeowners and investors.

Any homebuyer can be a victim of abusive mortgage servicing. The problems are not limited to families in bankruptcy, but they worsen in bankruptcy. While bankruptcy is supposed to offer families one last chance to save their homes, the reality is that bankruptcy gives mortgage servicers new opportunities to engage in abuse.

With Tara Twomey, I did a study that examined the court records that mortgage companies filed in over 1,700 Chapter 13 bankruptcy cases. The purpose of a proof of claim in bankruptcy is to establish the amount of a debt. Debtors must pay these claims or lose their homes. Unambiguous Federal law requires creditors to disclose information accurately. The law requires three pieces of documentation: a promissory note, a recorded mortgage, and an itemization of any interest and fees. Without documentation, parties cannot verify that the debt is correctly and legally calculated.

Yet mortgage servicers fail to comply with these basic requirements more than half of the time. A majority of claims—53 percent—lacked one or more of the required attachments as shown in this graph. Poor mortgage servicing in bankruptcy is not limited to one or two companies; it is the industry norm. This widespread noncompliance undermines the bankruptcy system. At worst, creditors' failure to provide documentation can manipulate the bankruptcy system to overpay on these debts. By obscuring the information needed to determine the legality of charges, servicers thwart effective review of their practices. Their blatant disregard for bankruptcy's clear rules effectively shifts the burden to debtors, trustees, or courts to engage in costly litigation to verify the purported debt. In a majority of bankruptcy cases, servicers flaunt their duty to disclose.

I also measured how frequently servicers attempt to collect fees or costs without identifying such charges. I found that 43 percent of mortgage claims either made reference to fees that did not fit into a category or they offered an aggregate sum of many charges. Some amounts were labeled "other" and some had no description at all. I found dozens and dozens of fees that appeared to be impermissible or should have been challenged. Some of these fees are shown in this table.

On their face, these fees are vulnerable to challenge because they may not be permitted under the terms of the note, applicable law, or the Bankruptcy Code. Yet none of these fees were objected to by any party. Debtors were forced to pay these amounts or lose their homes. In the rare instances when bankruptcy courts have scrutinized creditors' practices, they have found evidence of misbehavior. For example, Wells Fargo recently was faulted for charging for property inspections, allegedly conducted in Jefferson Parish, New Orleans, while that area was under an evacuation order and was closed to everyone but emergency personnel.

Many creditors request payment in their proofs of claim of thousands of dollars more than debtors thought they owed. In the average instance, when mortgage creditors tried to collect more than the debtor expected, as shown by the red line, the average discrepancy was over $6,000. For struggling families in bankruptcy, this is a formidable amount. Faced with these debts, many families lose their homes to foreclosure despite having filed for bankruptcy.

This is an example of a typical claim that we saw in our study. I would like to highlight a few things. The debtor in this instance was 8 months behind. This is a VA loan serviced by a servicer the VA selected. The debtor was charged property inspections of $511. That is over $70 a month in property inspections. The $389 held in suspense, the debtor scraped up that money, sent it into the servicer, and the servicer did not apply it. Instead it held that money bearing interest for itself while the debtor's account continued to accrue interest.

The current bankruptcy process is malfunctioning, and the industry has had ample warning about its problems. In the face of attacks by the U.S. Trustee in courts, mortgage servicers have refused to improve. This past year has shown that no other entity—neither debtors, nor their attorneys, nor panel trustees, nor the U.S. Trustee, nor the bankruptcy courts—is willing or able to address the assault. Systematic reform is needed to protect all homeowners—inside and outside of bankruptcy—from illegal behavior.

[The prepared statement of Ms. Porter appears as a submission for the record.]

Chairman SCHUMER. Thank you, Professor Porter.

And now, Ms. Atchley.

STATEMENT OF ROBIN ATCHLEY, BALLGROUND, GEORGIA

Ms. ATCHLEY. My name is Robin Atchley. I am honored to testify before the Subcommittee about my family's struggle to save our house from foreclosure in the bankruptcy court. My husband, John, and my children, Kally, Payden, Alec, and Morgan, are with me here today. Our lawyer, Howard D. Rothbloom, is seated behind me.

I work as a letter carrier for the U.S. Postal Service. John works as a lineman for the power company.

In 2004, our family moved from a single-wide mobile home into our own brand new house that we bought in Waleska, Georgia. We put down $22,000 on the house, and we financed the rest.

One year later, our mortgage was refinanced by American Freedom Mortgage to put up a fence and to finish the basement so that our children would each have their own bedrooms. We did most of the work ourselves. We were notified to make payments to a company called "Countrywide."

For some time, we were able to keep up with our payments to Countrywide. But when my sister passed away unexpectedly, I needed time to grieve. So I took unplanned and unpaid leave from my job.

Then we struggled to pay our bills. We didn't have much debt, but we did fall behind on our mortgage payments.

Our attorney explained to us that in Georgia, a mortgage company can foreclose in just over a month without going to court. So, in October 2005, we sought refuge in the bankruptcy court. We had hoped that bankruptcy would allow us time to pay our debts and keep our house.

When we filed for bankruptcy, we were about $5,000, or three mortgage payments, behind. The $5,000 was to be paid in monthly installments through the bankruptcy court, and the current due mortgage payments were paid monthly directly by us.

Our bankruptcy case was a tug of war with Countrywide over our house. Sometimes our mortgage payments were late. But Countrywide, through its lawyers, McCalla Raymer, was too quick to pull the trigger. Legal papers became weapons.

In February of 2006, Countrywide filed a motion for relief from the automatic stay asking the bankruptcy judge for permission to foreclose on our house when we were current on our mortgage payments. Both times, not until our lawyer gave McCalla Raymer proof that the payments had been made, did Countrywide withdraw its motions. It was unforgiving. It seemed that we had no room for error. And each time that it sought permission to foreclose, there was confusion: no person with Countrywide or with McCalla Raymer could ever give us clear information on what they claimed that we owed and why we owed it. It was as if all they wanted to do was take our house.

We had hoped that bankruptcy would give us a fair chance to save our house. But that was a false hope. It seems as if Countrywide used the bankruptcy court to gain even more opportunities to take advantage of our predicament and to profit from our struggle.

Nonetheless, with our lawyer's help, we won the battles.

Eventually, however, John and I just tired of the war. And it took a toll on our whole family. Our son, Payden, even insisted that we use his lunch money to help pay the mortgage payments.

We did the best that we could. Our lawyer did the best that he could. Together, we did the best that anyone could.

Our house was our family's first house. It was our dream home. John and I had hoped to raise our children there and live there for the rest of our lives. But, regretfully, John and I decided that it would be best to sell it. The monthly bankruptcy payments, the monthly mortgages, and the whole bankruptcy process were drowning us. We knew that selling the house would enable us to get our heads above water.

In May of 2007, Countrywide sent a Payoff Demand Statement showing that the total amount owed on our loan was $199,000. The proof of claim Countrywide filed in our case in December 2005, however, showed that we owed $185,000—$14,100 less than the payoff amount demanded by Countrywide—and that is without giving us credit for post-petition mortgage and bankruptcy court payments sent to Countrywide. Yes, we were behind on our payments on the day that we sold our house, but we don't know why the payoff amount was so high. The payoff statement included $2,550 in unexplained fees.

We sold the house in the middle of May and paid the amount that Countrywide said that we owed. In fact, we had to pay money out of our pockets at the sale to get out of the house. That just didn't seem right. And, according to our lawyer, Countrywide continued to take money from us through the bankruptcy court even after it was paid in full from the sale. That didn't seem right either. They didn't stop until after our lawyer objected.

The saddest day was the day that we told our children to pack everything in their bedrooms. With suitcases in hand, my husband, our four children, and I stuffed the car with our belongings and moved in with my parents until we could save enough money to rent.

We are not bad people. We work hard. We try to follow the rules. John and I are trying to raise our children to be good and decent. We are probably just a typical American family.

Our house is gone. There is nothing that anyone can do to change that. Now our home is a house that we rent from someone else. And our son doesn't have to worry about his lunch money anymore.

We hope our story will help others. Thank you.

[The prepared statement of Ms. Atchley appears as a submission for the record.]

Chairman SCHUMER. Thank you, Ms. Atchley. I want to thank all the witnesses, particularly you, Ms. Atchley. I know it is not easy to come and talk about it, but it will help others.

Ms. ATCHLEY. I hope so.

Chairman SCHUMER. I want to assure you of that, so you are doing a good deed for others, and I would like your children to know just that about you.

Ms. ATCHLEY. Thank you.

Chairman SCHUMER. We have a vote. I think we have about 4 minutes left. So I think we will take a brief recess. There are three votes, so we will try to resume at about 3:15. As soon as we begin the third vote, I will vote quickly, Jeff will, and we will come right back and begin questions.

The hearing is temporarily recessed for a half-hour.

[Recess 2:46 p.m. to 3:20 p.m.]

Chairman SCHUMER. The hearing will come to order. I am sure Senator Sessions will be here shortly, but we do want to move along. So we will try to do 7-minute rounds for questioning, and then we will come back. My questions first are to Mr. Bailey.

Now, Mr. Bailey, in a news release last fall, Countrywide stated that, "Our No. 1 priority is to help borrowers stay in their homes." And you said, "At the end of the day, foreclosure avoidance is the theme we are going after." You have also said that, "Foreclosure is always and absolutely the last resort." And today, you repeated similar comments in your testimony.

Now, I just want to test that commitment. First—and please answer as succinctly as you can, because we have limited time. Isn't it true Countrywide holds only a fraction of the loans it services on its books?

Mr. BAILEY. Yes, that is true.

Chairman SCHUMER. What is the percentage?

Mr. BAILEY. It is about one in eight.

Chairman SCHUMER. OK, so that would be about 12 percent. And so if you are not holding a particular home loan on your books, that means you will not have to take any writedown in the event of foreclosure on the home. Isn't that correct?

Mr. BAILEY. That is not necessarily true. Some of the structures of deals that we have have a loss position, even if the loan is not on our books.

Chairman SCHUMER. And how many are those? Small number, right?

Mr. BAILEY. No. Several hundred thousand.

Chairman SCHUMER. What percentage is that?

Mr. BAILEY. That is probably another 10 percent.

Chairman SCHUMER. OK. So still, three-quarters are not in that situation. OK. And so for the vast majority of loans you service then, I think it is fair to say the bulk of the adverse financial impact from foreclosure is borne not by Countrywide but by the ultimate investor, at least on three-quarters of those.

Mr. BAILEY. It won't be exactly that math because the loans, especially the couple hundred thousand, have a much higher risk.

Chairman SCHUMER. I am not trying to get an exact number here.

Mr. BAILEY. OK.

Chairman SCHUMER. It is the concept, and I don't think we dispute that.

Mr. BAILEY. There is significant risk outside of Countrywide's book, yes.

Chairman SCHUMER. OK. Now, let's assume that, as you predict, the housing market, as you predict, as most analysts have, the housing market continues to slide, and you believe you are servicing many loans that have a high likelihood of default—the Option ARM that you have originated in areas that are experiencing steep home depreciation, like California.

In those circumstances, isn't it true that Countrywide's business model is to offset the servicing losses from defaults and foreclosures by levying a host of ancillary fees on the borrower before there is nothing left for a borrower to give?

Mr. BAILEY. That is a good question. I hope to get a little bit of time to respond to this, because I hope to bring some clarity to this, because it is a question that continues to come up in form or another.

Chairman SCHUMER. OK.

Mr. BAILEY. The idea that if we sell a loan to investors, so Freddie or Fannie or HUD is insuring it, if we don't have the ultimate credit loss risk, if that is removed, then the idea that levying fees that aren't necessary or taking income through a subsidiary will then give us an incentive to want to foreclose where foreclosure might not be necessary, is a question that continues to come up. So just—I will try to keep—

Chairman SCHUMER. Or that other fees, if you raise other fees on the route to foreclosure or after foreclosure, they will mitigate—you know, they will make you more profitable. Same thing.

Mr. BAILEY. Same general question. So a couple of points.

The first one is the most primary way that we make money in the servicing model—put aside the idea that you have a loan on your books. This would be for loans that are not on your books. The primary way you make money is if a borrower is making payments. So the service fee that you collect is what you withhold from what you would pass through to an investor. If you did not collect a payment—

Chairman SCHUMER. Sir, we are limited in time. That is before any foreclosure, correct?

Mr. BAILEY. But it—the main motive is to keep that loan on the books and keep the customer paying. That is how you get the bulk of your payments.

A second way you make money is money that you hold, whether it is in escrow money waiting to disburse in the future or principal and interest you are holding prior to advancing it to an investor, you make money on float. You don't make any float if a payment didn't come in. So, again, these—

Chairman SCHUMER. But you can make money from fees extra fees. Let me read to you a few things here, OK?

Mr. BAILEY. If I could—

Chairman SCHUMER. I just want to get these out, and then you can answer.

Mr. BAILEY. OK.

Chairman SCHUMER. Because, again, I want to—in your third quarter earnings presentation, you report that Countrywide's net loan servicing income more than doubled from $517 million from the second quarter to $1 billion in the third quarter. A huge increase in the fees for loan servicing. And then, let me read you this—this is Mr. Sambol, your President. In the report he says, "Now, we are frequently asked what the impact of our servicing costs and earnings will be from increased delinquencies and loss mitigation efforts and what happens to costs. And what we point out is, as I now will, that increased operating expenses in times like this tend to be fully offset by increases in ancillary income in our servicing operation, greater fee income from items like late charges, and, importantly, from in-source vendor functions that represent part of our diversification strategy, countercyclical diversification strategy, such as our businesses involved in foreclosure trustee and default title services and property inspection services."

What your President, Mr. Sambol, is saying is by charging people like Mrs. Atchley who are already in Chapter 13 or in foreclosure extra fees, you are going to make up for the losses you made in making bad mortgages. That is just what he is saying here, is he not?

Mr. BAILEY. OK, so—

Chairman SCHUMER. Can you answer that? Isn't that what Mr. Sambol is saying?

Mr. BAILEY. I can answer that question. It takes a little bit of time, if you will give me—

Chairman SCHUMER. OK.

Mr. BAILEY. First, again, in order for any of that income to come in an annuity that is going forward—let's take this late charge income—it would need to come from a borrower who made a payment. Late charges is overwhelmingly—of those items that he referred to, is overwhelmingly the biggest fee income that you get. Most of that comes from people who miss one payment, maybe two; they pay a late charge, and they are back on course. That is the overwhelmingly largest fee income that is there.

Second, this idea of these subsidiaries that are involved somehow on the periphery, involved in foreclosures that pursue, first, those actions are required in order to proceed with a foreclosure. They are directed. You have to hire an attorney. You have to go through the process in court in order to enforce the contract. Those fees are going to be collected by someone, whether it was a Countrywide subsidiary—but—

Chairman SCHUMER. That is not—Mr. Bailey, in all due respect, to say someone is going to collect these fees does not answer the question whether it is in Countrywide's interest when they are losing money on the basic mortgage—

Mr. BAILEY. I will get to that—

Chairman SCHUMER.—in part because the person couldn't pay, to then pile on and charge the Mrs. Atchleys of the world—and there are hundreds of thousands of them—extra fees. Your President says that is how you keep your profit model. Fee income increased greatly. So you are telling me that someone is going to have to collect these fees; if it is not you, it is someone else. That doesn't answer the question.

Mr. BAILEY. I will get to this. I know it is frustrating to go through the details, but if I can get to the detail, I hope—

Chairman SCHUMER. But if you can answer my question.

Mr. BAILEY. I will answer the question. The point I am making about somebody is going to be paid a fee is if a foreclosure process—which, by the way, isn't the fees that were charged to the Atchleys, which I would love to talk about that in a minute. The foreclosure fees that are charged are set by State and investor allowables. We do not set the fees for these allowables. Investors do. As—

Chairman SCHUMER. Excuse me. Do you agree with that, Professor Porter or Ms. Miller? There are many fees that they set on their own and add on their own. Isn't that right?

Ms. PORTER. Some fees are set by the investors. Late fees, for example, are usually in the mortgage contract. Things like demand fees, fax fees—those are all in the discretion of the servicers.

Chairman SCHUMER. Exactly.

Mr. BAILEY. No, we are talking about foreclosure fees that are part of the subsidiaries.

Chairman SCHUMER. No, no, no. We are talking about all these extra fees, the kind of piling on that we object to, to make up for losses elsewhere.

Ms. Miller, is Professor Porter right, Trustee Miller?

Ms. MILLER. Yes, Your Honor. In fact, there was a new case that came out in the last couple of weeks in which the servicer actually admitted to the court that the BPOs, the broker price opinions, were actually sent out by a computer instead of by someone within a servicer, and so the BPOs would go out and continue to accrue to the account with no one actually being aware that they were going on the account.

Chairman SCHUMER. And those are in the discretion of Countrywide or with other—

Mr. BAILEY. So let me go to this issue of profitability and foreclosure.

Chairman SCHUMER. Yes, that is what I asked.

Mr. BAILEY. We have made a decision in order to put this to bed on foreclosures, whether it is a default title or whether it is a foreclosure processing, we made a decision to waive all of the attorney-related foreclosure fees for anybody who is trying to reinstate their loan out of foreclosure. So, actually, us holding those subsidiaries will be in a customer's best interest because it is the only place they are going to go where we can demonstrate we would much rather work this out, we would much rather that you would come current. We are going to forego—

Chairman SCHUMER. When does that take effect?

Mr. BAILEY. That already has been put in place this month.

Chairman SCHUMER. This month, so until this month, all the things you say you shouldn't do, you could have done, and in some cases did do.

Mr. BAILEY. Again, the fees are defendable by market, by legal proceedings, they are defendable. We are trying to go an extra mile and kill any belief that we would rather take income in a subsidiary for a foreclosure. We would much rather have the borrower remain in their home, have no fee, continue the loan, keep them in their home. We are company that is about homeownership. That is what we were founded on. That is what we are trying to be in the marketplace.

Chairman SCHUMER. Many of your practices—no-doc loans, charging people more than they could ever afford—call that into question. But we will get to that in a second round. My time is up.

I would just say this: that any business model that says we are going to make up for lost income in the regular mortgage process by extra fees and fees relating to foreclosure and default title services and property inspection in my judgment is not a company that wants to keep people in their homes.

Senator Sessions?

Senator SESSIONS. Thank you, Senator Schumer.

I would just like to run by the overall perspective here to me, where we are and what the problems are. Mr. Bailey, some of your cases, the In Re: partially I think was really appalling errors on behalf of your lawyers, and they filed information without assuring it is correct.

Do you—well, it is hardly worth asking. I am sure you say that it was not your policy to do that, but it has been occurring, and Professor Porter has indicated far too often and far too many cases. And some of this has been pointed out in Professor Porter's study that proper documents are not being filed with the proof of claim.

Now, Ms. Atchley, you were happy—I picked up from you conversation you were pleased that your attorney stood up for you and battled this thing successfully, ultimately, for you, were you not? I sort of felt that way.

Ms. ATCHLEY. Yes.

Senator SESSIONS. Ms. Miller, you are a bankruptcy trustee. Isn't the first responsibility, the first line of defense for a debtor in bankruptcy court the lawyer they hired to protect them and give them a fair day in court?

Ms. MILLER. Yes, Your Honor—yes, sir, it is.

Senator SESSIONS. I can tell you practice law a lot when you say that.

[Laughter.]

Chairman SCHUMER. Senator Sessions was—I was never a "Your Honor." I believe you—

Senator SESSIONS. No. I was a would-be Your Honor.

Chairman SCHUMER. He is a would-be Your Honor. I am a never-be Your Honor.

Senator SESSIONS. Yes, that is true. Both of us are in that category, I am afraid.

So that is the first responsibility. Now, my impression is—and this came up during the bankruptcy bill legislation, and we put some requirements on the lawyers for the debtors to certify what they filed would be correct. And we put some requirements on the lawyers for the creditors to be correct in what they filed. The debtors' attorneys all were nervous. Oh, they did not like this. "You mean we have got to actually certify what we filed is correct?" Because the truth is some of them handle hundreds and hundreds of claims per year, do they not? And their paralegals and assistants do all of this work, and they are unlikely to know much of what is in the file, too often. Would you confirm that as a reality of life?

Ms. MILLER. I think that there are some very large filers who that actually is the case. Actually, in our district, most of the attorneys are smaller filers, so I think they do a better job of knowing what is in their case and looking at their proof of claims. But it is an issue that we are dealing with.

Senator SESSIONS. And, of course, you file and you get your fee, and eventually the case goes away, and whether your client sometimes—exactly how well the client comes out gets lost in the process, I am afraid, because it is such a mass production deal for a lot of lawyers.

Now, why would not a lawyer for a debtor not object if the note or the proper proof of debt is not attached to the proof of claim?

Ms. MILLER. Personally, I believe that they should be. I do know—

Senator SESSIONS. I mean, they have the authority, do they not, to object? And what would a court do if a lawyer for the debtor said, wait a minute, the law says you have to have the proof of the documents, certified documents to prove the debt, and they haven't done so? What would a bankruptcy judge do under that circumstance?

Ms. MILLER. I know that in our jurisdiction we object to those proof of claims. We actually require the servicer to come in and prove that they are entitled to that right of payment. If they do not prove that they are entitled to that right of payment, the claim is actually denied.

Senator SESSIONS. The entire claim?

Ms. MILLER. The entire claim.

Senator SESSIONS. But let me ask you, say we object, is it the bankruptcy trustee that is objecting or the attorney for the debtor objecting?

Ms. MILLER. I think depending on the different jurisdictions—in some jurisdictions the trustees object; in some the duty has been shifted to the debtor's counsel. It is one of those local rule differences between the different courts.

Senator SESSIONS. Well, so does a debtor's attorney not have a responsibility to make sure that the proof of claim is legitimate? Has that been shifted to the bankruptcy trustee?

Ms. MILLER. I believe they always have that duty, sir.

Senator SESSIONS. And then what role does a bankruptcy trustee—what role do they play in evaluating these claims and proof of claims and motion for relief of stay? What do you do and what is your responsibility?

Ms. MILLER. We do a number of different things. We don't know exactly how far behind the debtor is, so we are not going to be able to determine whether or not the five or six payments, or whatever, in the arrearage and the proof of claim is correct. But we do review the proof of claim to see if there are outrageous inspection fees, origination fees, things like corporate advances, which means that they are not telling us what they spent the money on.

We also object if the mortgage is not attached, and sometimes the mortgage that is attached is in a different name. It is a different person.

Senator SESSIONS. Now, what happens if a creditor files a petition and you notice they have not filed the correct documents, and you call it to the attention of a judge by an objection? Does a judge ever sanction the attorneys for all this wasted time and effort because they did not file the document properly to begin with?

Ms. MILLER. Actually, Your Honor, my court has a very proactive stance on that, and my judge actually sent the U.S. Marshals out to one of the law firms in California to bring the senior partner to court to explain their actions in filing the—

Senator SESSIONS. Now, that gets attention, right?

Ms. MILLER. Yes, it did, Your Honor.

Senator SESSIONS. Probably sent a message throughout the entire bankruptcy bar in your district when the senior partner from Los Angeles is called to answer why his people filed improperly.

Ms. MILLER. It not only made our bar; it made pretty much the national bar.

Senator SESSIONS. So it seems to me that it is difficult for us to complain about these things—well, let me back up. I believe, my observation is, in the law and almost anything else, people will do what you are allowed to do. If you are playing football and they let you hold, the people are going to hold. If they are throwing the flag when you hold, they don't hold. If you are going to allow lawyers and practitioners not to do their job and not to issue sanctions, then you are not controlling the game. You are not in charge of the game.

I think ultimately it is the judge, but aggressive trustees and aggressive lawyers are critical to the integrity of the entire system. Would you not agree?

Ms. MILLER. I agree, sir.

Senator SESSIONS. Well, you as a trustee—I know my time is up, but you as a trustee are in the pit. You are down there dealing with these cases, and I know you have a feel for it, and I thank you for giving us that perspective.

Ms. MILLER. Thank you.

Chairman SCHUMER. Thank you.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you, Mr. Chairman, and thank you for calling this hearing. I think this is extremely instructive, and it is really a tragedy to see people like Ms. Atchley falling into what looks like a mill, basically, and with very little way to find their own way out in an area where everybody else is an expert but you are the one who has the home. And so I appreciate that you have come in, and I appreciate that so many people are here to help us understand this a little bit better.

It sounds like there is not only an abuse of the collections process, but widespread abuse of lawyering standards. Why is it that courts are not pushing back harder at all of this? You have given some instances where they have rattled some cages and called senior partners and so forth. But the recurring nature of this is really pretty astounding. I know Professor Porter has recommended some rules changes, but let me see if I can find the—you used a very good phrase: "unreliable mortgage servicing is pervasive...current provisions are not sufficiently strong to generate compliance." And if people—I just don't get why there isn't a harder smack being delivered by courts to these practitioners.

First of all, if you could define why it is happening. I suspect it is just a question of scale, and it is sort of mill production and people like Ms. Atchley get caught up in it, and they are filing just dozens of these things, and it is a sort of automatic process and they do not really care. They are just bombing the court with papers. But that would strike me—I have been around judges quite a lot, and that would strike me as really no excuse to most of the judges I have seen. In fact, it would be an aggravating factor in terms of trying to bring a little bit of order and discipline and integrity to the proceedings that they are overseeing.

Ms. PORTER. I do think we are starting to see judges take action. Senator Schumer gave some examples of some of the court opinions we have started to see. But I want to emphasize that this is, as Mr. Sessions noted, a high-volume system, and the scale and scope of the servicing operations make even the largest bankruptcy attorney look like a solo practitioner. So we have gigantic servicing operations. They employ national law firms. Those national law firms then in turn employ local law firms. And the mistakes and the overcharges just get passed down the line. Nobody bothers to stop and check.

I do think—you know, judges tell me—I have given this talk to a lot of groups, including judges. They say, "We hammer at the local attorney in front of us, and the local attorney tells us, 'We try to get information from our national counsel or from the servicer, and they do not give it to us. We don't know the answer to your question.'" And that leads to these orders to fly in executives from across the country.

The problem with taking a judge-by-judge, court-by-court approach, as Mr. Sessions was suggesting, is the rules already put the burden on the creditor to attach this documentation. That rule has existed since at least 1978, and the reason the rule is there, why the burden is on the creditors, is because they are the party with the information. By not attaching notes in 42 percent of their claims, Countrywide shifts that expense onto the debtors, onto the trustees, and onto the bankruptcy courts, and ultimately onto the system. And that is an abuse of the rules as they are currently written, in my view.

Mr. BAILEY. She has no evidence that we have 42 percent errors in this. You haven't checked us or audited us.

Ms. PORTER. It is in my—

Mr. BAILEY. We are submitting to this audit specifically to deal with this kind of general statement about it moves from the industry to—Countrywide has a 42—that is absolutely false.

Ms. PORTER. What I said, to be clear, was that in my—I will be clearer. In my study, there were 100 claims filed by Countrywide. There was no note attached to 42 of those claims. That means the note was missing in violation of Bankruptcy Rule 3001(c) in 42 percent of the claims. I consider that to be an error that harms a borrower.

Mr. BAILEY. How many of those cases, I wonder, would there have been an actual fee that was inappropriate or was objected to by either the debtor's attorney or by the judge or where there was any kind of sanctions or any problem issued with that? One of the problems we face—and I really hope—

Senator WHITEHOUSE. Let me just interrupt you for one second, Mr. Bailey, since you have jumped into this discussion.

Mr. BAILEY. Yes.

Senator WHITEHOUSE. Why is it that it is appropriate that there should—forget the fees and other things to the side. Why is it appropriate that your company should on those 58 occasions fail to comply with the bankruptcy?

Ms. PORTER. It was 42 they didn't—

Mr. BAILEY. It is the other way.

Ms. PORTER. In 42 they didn't comply.

Senator WHITEHOUSE. In 42 they didn't comply so they—

Ms. PORTER. They complied in 58; they did not comply in 42.

Mr. BAILEY. It is the other way. This is—

Senator WHITEHOUSE. Why is it that in 42 they didn't do it?

Mr. BAILEY. Sorry.

Senator WHITEHOUSE. I mean, just stop right there with that one question.

Mr. BAILEY. My answer will be that—

Senator WHITEHOUSE. Why in 42 percent, in those 42 cases, didn't you just follow the rules?

Mr. BAILEY. Well, these rules that she is referencing aren't necessarily the way that a local judge or jurisdiction would want their process to proceed. So it is as simple as these rules are not consistently enforced. They are not consistently—if you reach a judge in a particular jurisdiction—

Senator WHITEHOUSE. Well, they are certainly consistently enforced if you file floods of these things and judges don't bother to enforce them. But it is still the rule.

Mr. BAILEY. Well, but what a particular—in today's environment, what a particular judge in a particular jurisdiction wants to see, whether it is in the proof of claim and what is attached to it, how you might itemize the different fees, what kind of evidence of those fees you want to submit, is set by that judge.

Senator WHITEHOUSE. But how about Mrs. Atchley? Isn't she entitled to something in this? Isn't the rule there for her benefit so she knows what is being talked about? It is not just the judge. That is why it is the rule.

Mr. BAILEY. I don't think the Atchleys' proof of claim was brought into question here.

Senator WHITEHOUSE. No, but somebody in her position. It is not just between you and the judge. There is somebody whose home is involved here, right?

Mr. BAILEY. Right. What I will say—

Senator WHITEHOUSE. And they are entitled to notice pursuant to the rule, and I don't know why we are even having a discussion about compliance with the rule. Why is it suddenly optional to comply with the rule?

Mr. BAILEY. It is not optional to comply with the rule. The issue would be what is the rule and how is it defined by these local groups. As I said a few minutes ago, we are passionately interested in this idea that we would have best practices, clarification of what is required across the board. If in every case every judge wants all these things, that is what we will do. We will attach. If every fee needs to be itemized, that is exactly what we will do. And we are committed to that. We want the playing field to be defined and clarified and not have this variation. And even the fees that are charged, let them be uniform, let them be set, let there not be any variation between those things. And even further, can we establish better interaction between the debtor and the servicer? And that is in these best practices where there is some specific language and notices that you can send out to customers so they are not wandering blindly knowing whether or not a payment was received or if a fee was charged, so there is an interaction that can be increased between these parties, even if it deals with going through the trustee. Today there is not enough communication.

If Mrs. Atchley's presence here serves one thing, it is can we please deal with the interaction between servicers and customers. When we are under the cloak of bankruptcy and we are not allowed to have this dialog with the customer—I think she made an extremely good point. It underscores the tragedy of that situation. She admitted to there being a few payments that were late and felt that the trigger was pulled too quickly in these motions for relief, because, yes, they might have been a little bit late, but they wanted to pay and they were trying to pay. We can't have a conversation with her about that to see is the payment on the way. Was there just a little 1-month problem? We are stuck between a rock and a hard place. An investor is going to come down on you if you do not file that motion for relief within a certain period of time. And an inability to contract the customer to see if there is something going on that could be improved—even all these loan modifications that we can do now, I can't have a conversation with the customer about the ability maybe to rework their mortgage.

If we can get that dealt with—I know you can't change the whole process, but if we can get that dealt with so you can have some kind—if it is through the attorney, if it is through just letters that you can send, it can help to prevent a future tragedy where somebody wants to pay and is caught just being a little bit late for some interruption. And if we can get that kind of change, we are 100 percent for that.

Senator WHITEHOUSE. My time expired some time ago, and I appreciate the Chairman's indulgence.

Chairman SCHUMER. No problem. We are going to have a second round if you wish to stay.

Senator Feingold?

Senator FEINGOLD. Thank you, Mr. Chairman. Thank you for holding the hearing. This is a very important topic which has an impact on millions of Americans. While Wisconsin has not been as hard hit as other regions of the country by the subprime mortgage crisis, foreclosures are on the rise in the State, and more and more I hear concerns back home about the effects of the rising number of foreclosures on our communities. I have heard from local government officials who are concerned about holding lenders accountable for maintaining abandoned homes and ensuring the abandoned homes do not fall into disrepair. I have heard from housing advocates concerned about borrowers who may have been misled into taking out a subprime loan and now face the prospect of losing their homes. And I have heard from dedicated lawyers and counselors who are trying to provide counseling and other services in order to help individuals and families through these tough times. Helping families avoid foreclosure should be a top priority of Congress.

For some families, bankruptcy provides an entirely legitimate way to prevent foreclosure. This is exactly the purpose of Chapter 13—let people pay their past due debts over several years under the supervision of the court and the trustee so they can stay in their homes. When foreclosure is avoided, everyone wins—lenders get paid, families aren't uprooted, property values are protected, and communities are strengthened. Of course, if Congress continues to refuse to give bankruptcy courts the power to modify the terms of subprime mortgages, even going into bankruptcy will not help some families. But it can still work in some circumstances.

That is why it is so shocking and disheartening to learn of the abuses of the bankruptcy process by mortgage servicers. At the very point when families are trying to straighten out their affairs and do the right thing by their creditors, including those who hold their mortgages, they are being taken advantage of and pushed again to the brink of foreclosure. These abuses, or even mistakes—if that is what they are, are inexcusable. We know that some businesses will provide from these tough economic times. That is probably unavoidable. But to cheat and steal from hard-working people who are down on their luck and are trying to do the right thing is just unacceptable.

I am also concerned that we are beginning to learn that the practices of these companies may not be limited to bankruptcy cases. Millions upon millions of Americans have mortgages. They are told how much they owe, and they pay it. Month after month after month. They assume that the calculations of the mortgage servicing companies are correct and that their payments are properly credited. Very few people, of course, have the ability to analyze the amounts listed on their payment coupons or their annual statements and figure out if they are accurate. And if they start having trouble with their payments, most people can't determine whether the fees and charges they are assessed are legitimate.

So I commend the U.S. Trustee and the Chapter 13 trustees for putting more effort into scrutinizing these cases and the claims of these servicing companies, and I applaud the bankruptcy judges who have used their power to sanction companies and law firms that engage in improper practices. The Department of Housing and Urban Development needs to do more to address these issues. But I think it is also pretty clear that changes in the law are needed as well to help the trustees and judges recognize and stop these tactics and to provide the kind of sanctions that are needed to deter them. I am prepared to work with you, Mr. Chairman on legislation, and I hope the Judiciary Committee will take the recommendations that come out of this hearing very seriously.

Professor Porter, I assume you are familiar with the Best Practices document that the Chapter 13 trustees developed working with the mortgage servicers. Do you have any reaction to this? Does it go far enough to address the problem?

Ms. PORTER. I think the Best Practices are very, very good, and if they were ever to be adopted, that would do a lot to address at least some of these issues. My concern, which Ms. Miller addressed in her testimony, is these practices have existed for almost 2 years now, and at this time no servicer has fully implemented them. There is a voluntary procedure that Ms. Miller led to get them on board. They have been coming to committee meetings for 4 and 5 years now. And in the meantime, we have seen hundreds of thousands of families at risk of being overcharged as those years have elapsed.

So I would encourage the Bankruptcy Rules Committee to adopt the model form that the Best Practices Committee has developed and to put it into the background rules so that it is incorporated into the rules, and then those rules actually need to be enforced so that we do not get excuses from servicers that the reason they don't follow the rules is because the rules are not consistently enforced. It is a rule for a reason. The fact that you don't get caught doesn't change the fact that you didn't follow the rule.

But, generally, I approve of all of those practices, and I hope the Rules Committee will make some of them mandatory.

Senator FEINGOLD. Thank you, Professor.

Ms. Miller, I would be interested in your assessment of the legislative proposals and other suggestions contained in Professor Porter's testimony since some involve the powers and duties of the Chapter 13 trustees. Do you think her suggestions make sense?

Ms. MILLER. Yes, Your Honor, and—yes, sir. In fact, one of the things that Ms. Porter brings up is the trustees need to—we are actually working on teaching trustees, teaching the courts, teaching the U.S. Trustee about the mortgage servicer abuses and the systems. In fact, this summer, we are doing a full-day-long presentation for trustees and for debtors' attorneys, teaching them how to analyze the escrow statements, teaching them how to analyze the proof of claim so that if there are issues, they will have the forms and the tools in order to begin the litigation themselves. I think that that will really help the process. We will have more trustees, more debtors' attorneys on board. And I think that it speaks to Professor Porter's words.

Senator FEINGOLD. Thank you.

Mr. Bailey, I understand that you have had conversations with Ms. Miller about the Best Practices and now think it may be easier to comply. Ms. Miller testified, of course, that the Best Practices are now two years old, so one would hope that you would move a little more quickly.

How long do you think it will take for Countrywide to come into compliance with the Best Practices? And will you inform the Committee once you have done that, or let us know, let's say, within sixty days why you have not yet adopted the Best Practices?

Mr. BAILEY. You have my commitment—unless there is some piece that I was not aware of based on my conversation with Ms. Miller, there was just a couple of little pieces that were still problematic. But we will be the first to fully adopt it and will do that—

Senator FEINGOLD. How long will that take?

Mr. BAILEY. We will do it in a month.

Senator FEINGOLD. OK.

Mr. BAILEY. And, specifically, one of the things that was encouraging, one of the things we were troubled by was it seemed like a lot of the steps required filing different motions or different notifications with the court, and we were concerned—ironically, we were concerned with costs that that might pile onto the process that ultimately gets borne by customers. And we were preferring rather just to send direct notifications. You have heard me say a lot. I hope to have more clarity and freedom to send notifications so that customers can know what the statuses are and improved state. But I think they have done a lot of great work. She informed me on making it so that they are finding a way that you could submit those without having to engage an attorney, even submit those, you know, in a more data base manner, which I think is terrific. Also, there was a key on converting simple interest loans over the fixed-rate loans just because it was in bankruptcy, which we would not be contractually able to do, but they have taken that off the Best Practices list.

So we are ready to go, will be the first one in.

Senator FEINGOLD. OK. Thank you, Mr. Chairman.

Chairman SCHUMER. Thank you. We are going to do a second round, and I would just say, Mr. Bailey, I have followed Countrywide for a while, and you are always adopting good practices after you are exposed. I would like to see some—I would like to see Countrywide take a step before there is a negative article, a negative statement in a newspaper or on TV, and say you are going to do something to move this process forward.

But what I want to talk to you now about is your—and, by the way, my view, given the statements of Mr. Sambol and given the model that Countrywide seems to be using, once you adopt these Best Practices, if you actually abide by them—and I think it is good that you do—your profitability is going to go down because a huge percentage of your income and an increasing percentage is from many of these fees. And my guess is a good percentage of these fees won't be allowed under the Best Practices.

But let's go to your internal review. You have indicated that Countrywide has completed a number of internal reviews that indicate an error rate of less than 1 percent for mistakes that adversely impact a borrower. I must say, given the track record, it is hard to believe the error rate is so low. I wouldn't give you credit for it based simply on say-so.

So the first question I have is: How many—and you used the word plural. How many internal reviews were conducted?

Mr. BAILEY. Just maybe to address your broader concern—and I will answer that question in just a second. We expect, whether it is your own concerns based on your perspective from the comments you made a minute ago, or others, we expect that—we don't expect somebody to say, hey, so they did an internal review, that is great, then there is nothing to worry about. That is why the announcement today about we are going to hire a certified third party, let those results drive either—if it is worse than what we said, let that be known. If it is as we said, let that be known. But even if the error rate is what we said from this third party and they uncover further Best Practices—like one of the big Best Practices we have adopted—and I am not aware anybody else has—is how much review we are doing after we have given information to an attorney before they are going to submit it with the court. We did not used to do that. We relied on the attorney. We have changed that. We believe that should have a big impact on errors going forward.

If that is not enough and this review reveals that there are further things we should do, we are going to be committed to doing those further things. We do not want to be associated with errors or unnecessary fees at all.

Chairman SCHUMER. OK. So let's go to these questions. How many internal reviews were conducted, since you used the word plural?

Mr. BAILEY. There has been ongoing reviews for the last couple of months—

Chairman SCHUMER. Mr. Bailey, I am going to ask you to answer my question. How many?

Mr. BAILEY. Are you talking about types of reviews or accounts?

Chairman SCHUMER. Well, I said "internal reviews." I will get to accounts in a minute. How many reviews? You used the word plural. Most people would say, "We did an internal review." You are saying, "We did internal reviews."

Mr. BAILEY. Sure. There have been at least three.

Chairman SCHUMER. Three. OK. Who conducted them?

Mr. BAILEY. Various groups within the company.

Chairman SCHUMER. OK. That doesn't really answer my—

Mr. BAILEY. Well, it wasn't—

Chairman SCHUMER. Various employees of the company.

Mr. BAILEY. Yes.

Chairman SCHUMER. From the auditing division?

Mr. BAILEY. One of them.

Chairman SCHUMER. One. And what were the other two?

Mr. BAILEY. From people within the—people that report to me.

Chairman SCHUMER. OK. When were they conducted and completed?

Mr. BAILEY. Over the last couple of months.

Chairman SCHUMER. And why did you announce them today? Why did you announce the three-point plan today if they were finished—a while ago? Were they finished a while ago?

Mr. BAILEY. Not all of them were finished. Some of them were done recently.

Chairman SCHUMER. OK. Any outside counsel, auditors, or experts involved, or was it totally internal?

Mr. BAILEY. Internal so far, but, again, that is why we are—

Chairman SCHUMER. I know what you said today. I am asking about the previous review because that is what you trumpeted. Why didn't you engage anyone from the outside here?

Mr. BAILEY. It is just a matter of time. It would be the next logical step that we would go to.

Chairman SCHUMER. And why did these reviews only start a few months ago?

Mr. BAILEY. Again, this is part of adopting the new practices, of having further reviews of these—

Chairman SCHUMER. So would you say, sir, given everything you have said, that say 6 months ago, given all the changes you have made as of today, and you are proud of those, would you say that 6 months ago you weren't doing the right thing here?

Mr. BAILEY. No, I wouldn't go that far, because—

Chairman SCHUMER. So why—

Mr. BAILEY.—these reviews—

Chairman SCHUMER. Wait, wait. Let me just ask—

Mr. BAILEY.—didn't only just deal with recent transactions. They dealt with transactions—

Chairman SCHUMER. So I am asking, on the previous transactions—here you are, you are adopting new rules, you did your own review a few months ago. Today you are announcing an outside review. I think any good company practice would have had an outside review from the get-go. And, again, each one you seem to have to be pushed and prodded and moved along to take little steps in the right direction.

Can you give me the reasoning why—can you tell me, do you think a year ago Countrywide was doing everything perfectly right? Or, in retrospect, were there things that they could have done better?

Mr. BAILEY. I think the error rates were low. I think that the error rates we are quoting would be pretty close to what they were a year ago. We were doing lots of reviews a year ago. We are doing more reviews, again, trying to get the—

Chairman SCHUMER. I didn't ask that. I said overall. You are now adopting Best Practices. Does that mean your practices weren't good 6 months ago?

Mr. BAILEY. No, I don't think that is true.

Chairman SCHUMER. They were good?

Mr. BAILEY. I think they were good 6 months ago.

Chairman SCHUMER. OK. Let me ask you this: Were there samples used, or did you go over all the data in these last three reviews you did?

Mr. BAILEY. Two different types. Some of them do the whole population of recent filings. Other ones did samples.

Chairman SCHUMER. OK. And what does it mean, "mistakes were made"? In other words, if a fee was supposed to be charged—and I might think and Ms. Miller might think and Professor Porter might think and Ms. Atchley might think that those fees were over—shouldn't have been imposed at all or were much too high.

But if the fee charged was the fee proposed, I take it that wasn't considered one of the 1 percent. That wasn't a mistake.

Mr. BAILEY. It would be a mistake to charge a fee that was either illegal or over an investor allowable.

Chairman SCHUMER. I didn't say "illegal." I said a fee that we think shouldn't have been offered—in other words, how do you define "mistake"? You just said everything they did a year ago was just fine. So the only type of mistake is it said they were supposed to charge them $20 and they charged them $200. That would be a mistake. But if the actual $20 was charged, that would not be a mistake, right?

Mr. BAILEY. If it was a legitimate and appropriate fee, that is right.

Chairman SCHUMER. Right. And your version of what is a legitimate and appropriate fee is changing. The company's version is changing by the very basis that you are adopting these Best Practices today and it will change your practice of what you did previously.

Mr. BAILEY. Not the view of an error wouldn't change. The effort to try to prevent an error.

Chairman SCHUMER. So, in other words, these Best Practices were being followed all along?

Mr. BAILEY. No, that is not what I said.

Chairman SCHUMER. Well, I don't quite get what you are saying, sir. I am asking you—first you tell me everything was fine a year ago. Then you are telling me that you are adapting Best Practices today. Then you are telling me what you did a year ago does not meet those Best Practices. Are the Best Practices an improvement?

Mr. BAILEY. I think they will be an improvement in the whole industry, yes.

Chairman SCHUMER. I didn't ask that. I said for Countrywide.

Mr. BAILEY. Yes, I think they will be—

Chairman SCHUMER. So you have improved on what you are doing, but everything was fine a year ago.

Mr. BAILEY. Well, I think any error that resulted in unnecessary fees—

Chairman SCHUMER. We are not talking about errors. There is a difference. You, very cleverly I think, defined this as "mistake." "Mistake" is a flexible word. "Mistake" usually means there was a numerical error or something like that. I would say charging someone in bankruptcy an extra fee for, say, xeroxing, I would say that is wrong. But you wouldn't qualify that as a mistake, right?

Mr. BAILEY. We don't have any fees—I know you didn't mean—

Chairman SCHUMER. I understand. If you did. What is a fee that you did charge? What is a fee that you charged Ms. Atchley?

Mr. BAILEY. A fee to process a motion for relief.

Chairman SCHUMER. OK. Do you think that is still correct to do?

Mr. BAILEY. Yes.

Chairman SCHUMER. So you don't think that is a mistake. Does that conform with Best Practices, Professor Porter?

Ms. PORTER. It would be appropriate to charge a fee for a motion provided that the fee actually represented the honest amount that Countrywide was charged by the attorney, not a flat fee that was negotiated with fee-sharing or—

Chairman SCHUMER. In the past, did you charge a flat fee, ever?

Mr. BAILEY. We charge what the attorneys bill us.

Chairman SCHUMER. No, that is not—she said that is not appropriate.

Ms. PORTER. Most servicers, not just Countrywide, almost all servicers use flat-fee arrangements for things like motions for relief from stay.

Mr. BAILEY. This is a great example of—what we would like to see is a central group establish what is the right fee for a motion for relief. Everybody charge the same thing. We would love that.

Ms. PORTER. The right fee is what it costs the attorney in time and money to file the motion.

Chairman SCHUMER. Did you in the past always charge what it cost the attorney? Or did you add something on so Countrywide made some money?

Mr. BAILEY. No, never.

Chairman SCHUMER. Never.

Mr. BAILEY. There is no add-ons so Countrywide can make money on these fees—on a motion for—

Chairman SCHUMER. OK. So the fee that you charged was only the cost—

Mr. BAILEY. From the attorney.

Chairman SCHUMER.—of doing it from the attorney.

Mr. BAILEY. Yes.

Chairman SCHUMER. OK. And were there ever any kinds of arrangements where the attorney got something back for using—that gave you something back for using them?

Mr. BAILEY. No.

Chairman SCHUMER. Never, OK. So there is no—the fee never benefited Countrywide at all.

Mr. BAILEY. That is right.

Chairman SCHUMER. How did you choose the attorney?

Mr. BAILEY. Well, there are attorneys within the different States, and you look to people that have good practice. We keep scorecards on these attorneys. If they fail to perform, we will take action against them. So it is an evolving process.

Chairman SCHUMER. Professor Porter and Ms. Miller, from your familiarity with some of the things Countrywide did, did they meet the Best Practices all the time? Most of the time?

Ms. MILLER. No, Your Honor.

Chairman SCHUMER. No.

Ms. MILLER. No, sir, they didn't.

Chairman SCHUMER. They didn't. And give an example.

Ms. MILLER. Within the last few months, we had a case where, again, we paid the mortgage payment each time. It was Countrywide. We went to verify the mortgage at the end of the bankruptcy only to be told that they had not completed the RESPA escrow analysis, and they were demanding an additional $3,000 in order to have that mortgage be current.

Chairman SCHUMER. Mr. Bailey, did your company do that?

Mr. BAILEY. There is no doubt that we have gone through a period of confusion with escrow analysis. We have errors where we did not send escrow analysis when we should have. It—

Chairman SCHUMER. Was that a mistake or was that just something that you routinely did?

Mr. BAILEY. That is a mistake.

Chairman SCHUMER. Why is that a mistake? Did somebody in Countrywide violate your rules, or that was within the rules of Countrywide?

Mr. BAILEY. Both.

Chairman SCHUMER. OK. If the former, if it was within the rules, it is not a mistake. It is a bad policy. That is not how your audit defined "mistake." You know that.

Mr. BAILEY. I am not trying to be clever with this. Again, the whole idea is I am trying to get an external group to come in and audit these practices—

Chairman SCHUMER. As of today, as of the date of this hearing, you announced an external group, right?

Mr. BAILEY. Yes, but it will go back—

Chairman SCHUMER. Until then, it was always an internal group, right?

Mr. BAILEY. That review—

Chairman SCHUMER. With no outside—

Mr. BAILEY. That review is going to go back 3 years. We are not trying to say that whatever was—

Chairman SCHUMER. Are you going to make that public?

Mr. BAILEY. Yeah.

Chairman SCHUMER. And are you going to hire an accredited auditing firm?

Mr. BAILEY. Yes, and the second part was we are going to have an ombudsman, so people can—

Chairman SCHUMER. By the way, are you—

Mr. BAILEY.—turn to them to get reimbursed.

Chairman SCHUMER. Are you willing to make these internal reviews public, these three?

Mr. BAILEY. You know, I am—I don't know the answer to that question.

Chairman SCHUMER. Why wouldn't you?

Mr. BAILEY. Well, I wouldn't be the one to decide that.

Chairman SCHUMER. OK. Could you get us—we will send a letter to Mr. Sambol and Mr. Mozilo asking to make them public. Do you think they should be made public?

Mr. BAILEY. I think what is best is to set the rules of the external audit so that everybody can agree—

Chairman SCHUMER. No, but I didn't ask you that question.

Mr. BAILEY. I don't know the answer to the question.

Chairman SCHUMER. OK. Let me ask you this: One percent would be about 650 mortgages, right? Yet the trustee in Pittsburgh—I mean, in western Pennsylvania alone is looking at 300 Countrywide cases.

Mr. BAILEY. It is 293. That is a good question.

Chairman SCHUMER. Excuse me.

Mr. BAILEY. No, it is a good question because it all centers around the idea of what is an error and what is not an error. They are looking at those for a specific reason. We are working with them to sort through what is right and what is wrong. They have taken an interest in 10 of them. In the review of 293, they have sorted down to 10 they want to look at, and we are cooperating with them to see if they believe that there were improper actions or errors or fees or anything else related to that. So it is not 293.

Chairman SCHUMER. Ms. Miller and Professor Porter—and this is just a general question—does it seem credible to you that in 99 out of 100 mortgages that Countrywide serviced that they did everything OK?

Ms. PORTER. No.

Chairman SCHUMER. No. And why do you as you that, Professor Porter?

Ms. PORTER. Because I have looked at a sample of their claims, and I have looked at the way the servicers in general—and Countrywide is representative of the industry. I have looked at their actual filings. I have looked at 1,733 claims filed by mortgage servicers, and they do not meet the Best Practices. They contain errors.

Chairman SCHUMER. So are you sort of surprised when Mr. Bailey says a year ago everything they were doing was just fine?

Ms. PORTER. I am not surprised, because I already knew that to be untrue.

Chairman SCHUMER. How about you, Trustee Miller?

Ms. MILLER. Senator Schumer, unfortunately, with the failure of Countrywide to analyze their loans in compliance with RESPA, actually I would have to ask, No. 1, that the audits go back through every mortgage that is current in a Chapter 13 because if it is just once within the last 3 years, those people who are currently going to be discharged in the next 2 years are going to be the ones most—

Chairman SCHUMER. Good point. Would you be willing, Mr. Bailey, to have this external audit go back further than 3 years?

Mr. BAILEY. I think what our approach is is if we find, you know, any kind of errors that are beyond what we had said, we would absolutely go back further and include more people.

Chairman SCHUMER. Well, you are going to find errors by your own admission of about 1 percent. So will you be willing to go back more than 3 years?

Mr. BAILEY. We are going to do the initial audit the way that we have laid out, and we are going to look at the results.

Chairman SCHUMER. Mr. Bailey, this is the point I am trying to make. You want us to believe it is a new company, and you are going forward, and you want to do everything right. But whenever you are asked something specific—to make a document public, to go back further because there are people still before the trustee whose audits go back further than 3 years—you don't answer. And I am sure if there were three or four articles in newspapers or another hearing or two like this, you will come and put out a press release saying you are doing it, "Aren't we great?"

That is not what we are looking for here. In my judgment—and this is my own judgment—Countrywide is more responsible for the mortgage mess and the ensuing problems than almost anybody else. There is a lot of blame to go around, but you are way at the top of the list. And I have met with Mr. Mozilo and I have studied Countrywide. And I was surprised when Bank of America actually bought you, knowing what I knew about Countrywide. And I think

Bank of America is a good company. I am not casting any aspersions on them. And here today, again, you seem to me to be sort of trying to do the least possible to "get away with it," if you know what I mean. And I know you will find that a little harsh, but I would feel better if you said to me you are a high-up person, you are in charge of servicing, we are releasing these internal audits. I have no faith—I don't think anyone would, certainly Ms. Atchley wouldn't have faith in your own internal audit.

By the way, she wouldn't feel very good, even if it were 1 percent, if she were the 1 percent. But I doubt she is, because I think there are probably many more Mrs. Atchleys than the 1 percent.

But that is the problem we face here. Why wouldn't you go back further and audit 5 years or 6 years, since those are going to be some cases that are coming up now?

Mr. BAILEY. So the question is why wouldn't we go back further?

Chairman SCHUMER. I asked you would you be willing to go—this was not my suggestion. It was someone who knows more about this than me: Trustee Miller. And I saw Professor Porter shaking her head. And so it seems to me to be a reasonable idea. You say you want to get to the bottom of it. You say you want to make corrections. They are saying a 3-year audit trail is not good enough. And you intend, I guess, to audit every one, right, like Trustee Miller asked, every mortgage?

Mr. BAILEY. I think the point is to work on the details of that audit was something that, you know, was forthcoming. If the issue is you think we are hiding something by not going back 5 years, we will make it a 5-year audit. It is not—again, we are not—

Chairman SCHUMER. Is 5 years adequate, Ms. Miller, do you think?

Ms. MILLER. Sir, perhaps any mortgage that is currently in a Chapter 13—

Chairman SCHUMER. How about any mortgage that is current in Chapter 13?

Mr. BAILEY. I don't think you mean current. Any mortgage—

Ms. MILLER. Currently in—

Mr. BAILEY.—that is in the process.

Ms. MILLER. In Chapter 13.

Chairman SCHUMER. In process, yes.

Mr. BAILEY. Again, I think we have to start with a rational sample of that 5-year period and look at the results and see what practices or extrapolations are needed.

Chairman SCHUMER. And one of the things I am thinking of doing is asking the FTC to do a review, because I think that you are—I don't have much faith in your own—I have less faith in your own internal audit now after hearing the answers to the questions: no one from the outside, you can't really tell me why or when it started, how deep it was, how big the sample was, won't make it public. You can hire an auditor, and the more well known the auditor, the better. I hope it will be a well-known firm that has a reputation for independence and integrity, but we still may need an FTC audit.

And I guess I would certainly suggest to Bank of America that they do their own review and they do it soon.

Let me ask you this: Based on the 1-percent mistake rate—"mistakes"—and given some of the problems in the past, has anyone been fired or disciplined based on the internal reviews?

Mr. BAILEY. You know, I don't have the information.

Chairman SCHUMER. You don't know of any?

Mr. BAILEY. I don't know that.

Chairman SCHUMER. Wouldn't you? You are in charge of this department.

Mr. BAILEY. Not necessarily. If lower-level people would have been terminated, I wouldn't necessarily know that.

Chairman SCHUMER. OK. And let me ask you this: Will the future audit cover only bankruptcy cases, or will it cover all cases? Because there may be people who were being charged these fees, the mortgage is already signed, but who are not yet in bankruptcy, but who are having trouble.

Mr. BAILEY. I am not sure I follow that.

Chairman SCHUMER. The audit, you know, that you said you would do, you said you would do them of all cases already in bankruptcy. What about other mortgages that were issued where fees may be being charged post-mortgage that the mortgagor was not aware of, they may be related to acts of foreclosure, they may be related to other issues. Could we get the audit expanded to those types of cases?

Mr. BAILEY. That sounds like an extremely broad audit. I am not sure what the focus of it is.

Chairman SCHUMER. OK. I will write a letter. I will put in my letter to Mr. Mozilo and Mr. Sambol that request, and maybe we will get an answer to that.

I have a few more questions, but I will hand it over to Senator Sessions for a few minutes because he has been very nice. He said I could go as long as I wanted. But before I do, could I just ask Professor Porter and then Trustee Miller to comment on Mr. Bailey's general testimony here, just any comments you might have?

Ms. PORTER. The first comment I would make is that I will emphasize again to the Committee that I am very pleased that Mr. Bailey is going to be making some much needed and long overdue improvements. But I am concerned about the millions of families whose loans are serviced by Wells Fargo, by Ocwen, by Litton, by all the other companies that are not here today, and that is why I believe we need to do something systemic. I think Countrywide is a good place to start, but I am concerned that without incentives, the other servicers will not follow.

Chairman SCHUMER. Right. And, Professor Porter, we intend to do that, either legislatively adopt Best Practices, maybe go beyond the Best Practices, but we intend to actually do something that is required by all companies, not on a voluntary basis.

Do you have anything to say, Trustee Miller?

Ms. MILLER. I also am encouraged by Mr. Bailey saying that he will implement the Best Practices within the next month, and we will do everything that we can with the Administrative Office and the Courts and the U.S. Trustee Program and our organization to make sure they have the forms to get that done.

I appreciate that Mr. Bailey is beginning to look at the loans in bankruptcy, but I guess I just want to stress to Mr. Bailey that the loans that are going to be most at issue and the debtors that are going to be hurt the most are those that are closest to receiving their discharge, because without the RESPA analysis, we in the bankruptcy system do not have the ability and the time to perhaps pay the taxes and insurance that were missed by those prior escrow analyses. And to not do those first and do the current ones, I think that actually those older loans need to be done. Those need to be disclosed. They need to be sent to the trustee so that we can work with the debtors, work with Countrywide to try and resolve those, so that the people don't come out of the bankruptcy and immediately get an order of foreclosure from the court.

Chairman SCHUMER. What do you think of that, Mr. Bailey?

Mr. BAILEY. I think that is a very good suggestion.

Chairman SCHUMER. Good. I appreciate that.

Ms. Atchley, do you want to say anything here? I know you have been listening. But you don't have to. Only if you want to.

Ms. ATCHLEY. I don't think I have anything else to say.

Chairman SCHUMER. Thank you.

Senator Sessions?

Senator SESSIONS. Well, Mr. Bailey, Ms. Atchley is one of those that had unfair effects of errors in bankruptcy filings, and I suspect there could be more than 1 percent. And you see the pain that it has caused her. The time and effort that requires often for a bankruptcy court or bankruptcy trustees to get it straight and work it out, and it is—I just think it is an unacceptable thing for lawyers to not treat the bankruptcy filings with the seriousness I think they deserve. I think that is a big part of it.

Ms. Miller, the bankruptcy bill contained a new provision—the 2005 bill—on attorney sanctions. That provision can be applied to these attorneys that do not document their proof of claims or don't confirm the information filed as part of the bankruptcy position or filed incorrectly. In fact, that act, which strengthened the law, said, "The signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has performed a reasonable investigation into the circumstances, determined that the petition is well grounded in fact and warranted by existing law to be a good-faith argument." "Warranted by existing law to be a good-faith argument." And then the sanctions that are available, a court may award a debtor all reasonable costs, including attorneys' fees, in contesting the motion filed by a party in interest. But, in addition, the court has an inherent power, does it not, to sanction attorneys as options of the court for failure to adhere to high standards.

So under current law, it seems to me we have got some teeth here. Do you feel like that that could be more effectively utilized?

Ms. MILLER. Senator Sessions, if I am remembering the specific code section right, I think it actually references "petition" instead of "claim." And the problem is that that specific code—

Senator SESSIONS. I believe it says "petition, pleading, or written motion."

Ms. MILLER. OK.

Ms. PORTER. Then the question is whether or not a claim is a pleading. Certainly, inappropriate, unwarranted, groundless motions for relief from stay, which we have seen plenty of, would be a pleading, but the—

Senator SESSIONS. So you think there is some doubt in the minds of a bankruptcy judge—

Ms. PORTER. Absolutely.

Senator SESSIONS.—that a proof of claim—

Ms. MILLER. Yes, sir, I do believe that.

Ms. PORTER. And that later sentence you read, the second sentence, only mentions petition. It does not contain the broader language about pleading, and so I do think there is—that law is not being applied currently by bankruptcy courts that I am aware of to cover creditors' claims.

Senator SESSIONS. So basically then some of the actions would be covered. The proof of claim may not be covered, which is a serious part of what you found to be an error. Is that right, Professor Porter?

Ms. PORTER. Yes.

Senator SESSIONS. So it falls simply them to the inherent power of the bankruptcy judge to discipline lawyers who fail to live up to the high standard. Do you think clarifying legislation would be helpful there?

Ms. MILLER. Yes, I do, Senator Sessions. The other thing, if I could just continue, when we bring litigation against the mortgage servicers, there tends to be always an argument as to whether or not the trustee has standing to bring such actions and whether or not the bankruptcy court has the authority over the servicer to regulate the post-petition costs and fees and regulate their practices. And that is regularly brought up, as far as I know, in every litigation that has been brought up. And I think that one of the things, if there is going to be some legislation enacted, I really believe that we need to ensure that the mortgage servicing industry knows that they are subject to the bankruptcy court for the post-petition practices of their mortgages.

Senator SESSIONS. That is very interesting, and it is something I think we should consider, because to me a bankruptcy court depends on the professionalism of the analyst. The truth is these are not trials, often no witnesses. Often it is just petitions filed and accepted, and the debt is adjudicated by clerks and judges sign orders and lawyers have paralegals that fill out petitions. And so it does seem to me that we need to ratchet up the emphasis we give on accuracy in these cases.

Now, it has been said several times that the Best Practices have been out for 2 years, but according to your statement, I believe, Ms. Miller, in the fall of 2007 the committee members met in face-to-face discussion with various members of the judiciary and debtor counsel to attempt to finalize Best Practices. When was it, in fact, finalized?

Ms. MILLER. They have just been finalized. The provisions—the Best Practices, we actually—the ones that currently stand are the ones that have been there since May of 2005. What we have done is we have actually taken away some of the Best Practices. There was a provision regarding daily simple interest that Mr. Bailey talked about where they would convert the loans. There was a question about using the flat fees and the Fannie Mae step level billing that the debtors' attorneys had an issue with. But the notice provisions, the RESPA requirements to be filed each year, those have been in place and have been discussed and part of the Best Practices since May of 2005.

Senator SESSIONS. It seems to me a good Federal bankruptcy court to be effective has got to maintain certain standards and have clarity in its rules and procedures. But is it not true, Ms. Miller, that there are some that in certain areas of fees and penalties and costs, there are disagreements or there is uncertainty in the law as to what is appropriate?

Ms. MILLER. That is exactly right.

Senator SESSIONS. And to the extent to which that would be clarified normally by judicial interpretation and we move on, and if a lawyer persists in claiming fees that the court has clearly stated are inappropriate would be an abuse of their process, would it not?

Ms. MILLER. Yes, it would, sir.

Senator SESSIONS. So I think we need to work on that, although you don't want to intimidate lawyers from filing legitimate claims if they have a basis for it. Debtor lawyers sue the banks and the credit card companies and claim all kinds of things. Plaintiff lawyers file 10-page complaints alleging nine different allegations of misconduct, and maybe only one is good. And they think that is perfectly all right.

But I do think in bankruptcy court, we need as much clarity as we can have, and we don't need having to be litigating day after day after day over the same issues. How can we clarify that? You and Professor Porter could maybe comment on that. How can we clarify that?

Ms. PORTER. I think that is where there is really a need for congressional action, because I have given my presentation over a dozen times—probably closer to two dozen times—in the last 6 months. I have talked to the bankruptcy judges on several occasions. I have talked to the U.S. Trustee Office. I have talked to the panel trustees. I have talked to the debtors' counsel. I am tired of talking. And what I have come to realize is in every group I get the same feedback: "Professor Porter, this is a really serious problem. Thank you for documenting it. Those findings sound like what we see in reality." And then comes my favorite question: "Shouldn't this be somebody else's problem up and down the line?" So the trustees say it—you know, the U.S. Trustee encourages the panel trustees; the panel trustees encourage the debtors; the debtors encourage the creditors to get it right the first time; the bankruptcy court said they can't take action, they don't have jurisdiction.

So what I am really encouraging this Committee to do is to put the procedures into the Bankruptcy Code that Ms. Miller has identified and into the bankruptcy rules and create damages or enforcement provisions that are strong enough that we don't have servicers saying, "The reason I didn't comply with that is because it wasn't consistently enforced."

Chairman SCHUMER. And if my colleague would yield, that is just what we intend to do. At least just that. We may do more.

Senator SESSIONS. But I think we do need to listen to the courts and the experience of the litigant, the litigation, and what comes realistic and effective. But I absolutely think that if this is going to remain confused, the country would benefit by clarity so he can be held accountable, or Countrywide can, when it is absolutely clear. If there is some split of authority in claiming some fee and he has got a court somewhere that says he can claim it, it is hard to accuse him of abuse of process for claiming that fee.

I would note, Ms. Miller, that just looking at the bankruptcy filings, in 2003 there were a total of 1.6 million; in 2007, even with an increase, it was 850,000. So I would just suggest that bankruptcy trustees have fewer cases. And we expect you guys to be alert, and the judges have got fewer cases, and we need to be giving attention to these matters.

I thank you for highlighting it, Senator Schumer. This is a Federal court. We have set the basic rules for it. If there are imperfections in the rules we passed or we need to go further, let's do so.

But let's remember, Professor Porter, that—you know, you said that it shifts the burden to the creditor, but really when you go to court and you are asking to wipe out hundreds of thousands of dollars in debt so you don't have to pay it, you have got burdens too. These are not helpless people. They have got a lawyer, and the lawyer is supposed to be filing this and making sure that their clients' interests are protected, and that they should not allow a claim to go forward if they don't see the note and don't have proof of the debt.

Ms. PORTER. And I think some clarification of the rules and the law will motivate debtors' attorneys to do their jobs properly.

Senator SESSIONS. Thank you.

Chairman SCHUMER. Well, I look forward to working with you, Senator Sessions, on that.

I want to thank our panel. I think they have moved us in a very good direction. I want to thank you, Ms. Atchley. You may be in part responsible for some laws being adopted that would prevent other people from having to go through what you did. And I want to thank everybody, and I know, Mr. Bailey, this is not an easy hearing for you, so I appreciate your being here as well.

The panel is dismissed.

Chairman SCHUMER. We have a second witness, and that is Trustee Cliff White. Mr. White, we are running late

Mr. White, we are running late because of the votes. First, let me introduce you. Clifford White III is Director of the Executive Office for United States Trustees. He oversees the operation of the U.S. Trustee Offices nationwide. He is a former AUST, Assistant U.S. Trustee, and Deputy Attorney General with Justice.

Mr. White, I asked Senator Sessions. Neither of us have questions of you. We have been running late. Your entire statement is going to be read into the record. We knew you could not sit on the first panel because of the ongoing litigation, so I think I am just going to thank you, and we may submit some written questions.

Senator SESSIONS. Mr. Chairman?

Chairman SCHUMER. Senator Sessions, go right ahead.

Senator SESSIONS. I would like to thank Mr. White. The trustee does have a serious responsibility and was created for the purpose of trying to provide—ensuring integrity in the system. Isn't that right, Mr. White?

STATEMENT OF CLIFFORD J. WHITE III, DIRECTOR, EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES

Mr. WHITE. Absolutely.

Senator SESSIONS. And you all have filed, what, 74,000 enforcement claims and have stepped up on this Countrywide matter, and I appreciate that.

Do you think there is any ambiguity—the one question I would ask you—about a proof of claim being covered by the sanctions amendment that we discussed?

Mr. WHITE. There are clearly sanctions that can be attached to filing an inaccurate proof of claim. Now, much of the information you have gotten in the previous panel is very helpful and valid with regard to different practices and availability of sanctions and so forth. But when you pull it all back, what we are looking at, certainly what the U.S. Trustee is focused on in the litigation that I described in the testimony, is when inaccurate information is being filed by a creditor, inaccurate information which can be harmful to the debtor, it can be harmful to the creditor, and it certainly is harmful to the integrity of the system. And we have forcefully argued that we have the authority to bring those cases, and we believe the court has authority to forcefully impose sanctions to remedy those abuses.

So we think we have had some success. We are continuing despite vigorous challenges made against us by certain mortgage servicers. We are going to continue down this road, and we think we will continue to have some success.

[The prepared statement of Mr. White appears as a submission for the record.]

Chairman SCHUMER. Mr. White, you have our backing to do that, and I think you are doing a good job there, and we appreciate your testimony.

Mr. WHITE. Thank you very much.

Chairman SCHUMER. Before I conclude, I would like to do a few things: ask unanimous consent to enter into the record a statement by Senator Grassley; a hard copy of Professor Porter's study entitled "Misbehavior and Mistake in Bankruptcy Mortgage Claims"; hard copies of the slides used during Professor Porter's testimony; and a series of newspaper reports documenting the scope of the problem behind today's hearing.

With that, I want to thank the entire panel. I want to thank everybody for being here. This is going to start us off on a very serious road. I am also going to leave the record open for 1 week so that we can submit written questions of you, Mr. White, or of any of our previous panelists.

Thank you, and I thank Senator Sessions for his interest and, as usual, his erudition in matters such as these.

The hearing is dismissed.

[Whereupon, at 4:38 p.m., the Subcommittee was adjourned.]

[Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Countrywide®

4500 Park Granada
Calabasas, California 91302
(818) 225-3000

May 28, 2008

The Honorable Charles E. Schumer
Chairman
Subcommittee of Administrative Oversight and the Courts
United States Senate, Committee on the Judiciary
Washington, D.C. 20510

Dear Senator Schumer:

This letter is to address the questions raised by the committee members in your letter of May 15, 2008 that arose out of my prior testimony. I also have obtained answers for you to the questions (numbered 13 – 18) that relate to a recent *Wall Street Journal* article on Countrywide's Fast and Easy product, although that is a subject which is outside of my testimony and of my responsibilities at the company.

Questions from Senator Charles E. Schumer

I believe the first seven questions posed in your letter addressed to me have already been responded to by David Sambol in his response to your prior letter dated May 14, 2008. Accordingly, I will start my response at Question #8.

8) Countrywide does not fabricate documents. The misconception that we do arose from the *In re* Hill case, after a Countrywide employee chose to explain historical payment change information to Countrywide's bankruptcy counsel by using a format more simple to interpret (a letter) rather than a "screen print" from our computer system. The employee did not know or have reason to believe that the documents would ever be released outside of the attorney's office. Unfortunately, Countrywide's bankruptcy counsel misunderstood that the letters were for internal demonstrative purposes only and forwarded them to debtor's counsel. We regret the miscommunication between our bankruptcy department and our outside counsel.

The questions regarding the letter first arose in the context of a hearing in *Hill* on a different issue in that case. At that time, the judge questioned the attorneys involved in the case and concluded there was a need for the parties to conduct discovery to establish the facts. Since then, the Countrywide employee has provided the court with an affidavit explaining how the documents came to be, and has been cross-examined by the Executive Office of the United States Trustee, the local Chapter 13 Trustee and the debtor's attorney. Additionally, Countrywide's bankruptcy counsel has submitted to thorough cross-examination by the Executive Office of the United States Trustee, the local Chapter

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13 Trustee. Most notably, our outside counsel testified that she notified debtor's counsel upon learning of the miscommunication and that debtor's counsel responded that he was not concerned. The media articles and the quotes referenced in your question were all statements made prior to the time that the actual facts were presented to the court and, we believe that the articles and quotes are wholly unsubstantiated now that the facts have come out.

Countrywide has counseled the employee involved in the incident. In addition, Countywide re-enforced to all of its bankruptcy technicians that they are only permitted to send to outside counsel those letters which have been previously sent to the addressee and which are maintained on Countrywide's imaging system.

Countrywide is not aware of any other instances or cases involving allegedly "fabricated" or "recreated" documents being submitted to a court on its behalf.

9) As you know, late fees are amounts expressly set forth in the mortgage contract, and are only assessed after a contractually specified "grace period" following the date the payment was originally due. The fee, which is included in our servicing income when the fee relates to loans serviced for non-affiliated entities, is a charge assessed against a borrower on a loan when a payment is not made before the grace period expires.

Specifically, you asked about the company's late fee revenues. Contrary to the figure quoted in the *New York* Times article, late fees constituted 5.7 percent of Countrywide's servicing revenue in 2006 and 6.5 percent of the servicing revenue in 2007. This percentage has remained fairly consistent over time. The chart below provides historical data on late fees as a percentage of Countrywide's servicing revenue.

2002	6.4%
2003	5.4%
2004	5.6%
2005	5.5%
2006	5.7%
2007	6.5%

10) The only amounts that Countrywide recovers through the bankruptcy process are those amounts paid to it by the bankruptcy trustees. Countrywide does not profit or generate additional fee revenue from borrowers in bankruptcy. In fact, the opposite is true. For example, as we testified to the Subcommittee, Countrywide waives all post-petition late charges for borrowers in bankruptcy despite being legally permitted to collect such fees.

During a Chapter 13 bankruptcy case, the borrower is typically required to maintain his or her regular monthly contractual obligations, in addition to staying current on the bankruptcy plan. Unfortunately, about 50 percent of Countrywide's Chapter 13

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borrowers are delinquent at any one time on their regular monthly obligations. These defaults can lead to charges on the account, but the fees charged or assessed against the account are either fees billed to Countrywide by third parties for services provided, such as attorneys' fees, as well as other fees normally imposed on delinquent accounts (whether or not the borrower has filed bankruptcy) such as property inspection fees which are paid to a Countrywide affiliate.

11) I am not aware of any meetings, documents or analyses regarding a plan, policy or practice to become "aggressive" in imposing or collecting fees from borrowers who have filed for bankruptcy protection.

12) Consistent with our contractual obligations, Countrywide has always sought to maximize recovery and minimize losses on all loans on behalf of its investors. As I stated during my testimony, no one benefits from a default or bankruptcy and we are committed to helping our customers get back on their feet and stay in their homes whenever possible. Among the steps we take to make sure that losses are minimized are the following:

- Countrywide has extensive policies and procedures governing all aspects of the servicing of loans in bankruptcy to ensure compliance with state and federal laws, local Bankruptcy Court rules, and specific orders of the Bankruptcy Court with regard to individual loans. Countrywide has expended considerable effort to add staff and improve procedures in its bankruptcy department to ensure the accuracy of accounts and pleadings filed with the Bankruptcy Courts. Many of these procedures are designed to accommodate the borrower, including the waiver of late fees discussed above. Countrywide also voluntarily waives attorneys' fees in some circumstances. Finally, even though Countrywide is entitled to petition the Bankruptcy Court for relief from an automatic stay after the first post-petition delinquent payment, Countrywide's policy is to wait until the borrower has missed two monthly payments before filing for relief.

- Where allowed by law and the borrower's loan documents, Countrywide seeks recovery from borrowers of fees billed to Countrywide by third parties for services provided, such as attorneys' fees, as well as other fees normally imposed on delinquent accounts (whether or not the borrower has filed bankruptcy) such as property inspection fees which are paid to a Countrywide affiliate. As discussed above, Countrywide has policies in place to waive fees in appropriate circumstances.

- There has never been a plan or strategy to offset losses from defaults by recovering fees, penalties or other amounts in bankruptcy. There are no penalties assessed against borrowers in bankruptcy of any kind.

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- There is not, nor has there ever been, a compensation structure for either Countrywide employees or our outside counsel based on the success of obtaining amounts owed from borrowers in bankruptcy.

13) The presentation referenced in the *Wall Street Journal article* was one prepared by Countrywide's Correspondent Lending Division. That Division of the company purchases loans that have been originated and closed by another lender. I was not aware of the presentation until your request, nor did I did attend or participate in the presentation. Per your request, a copy of the presentation is enclosed.

14) By definition, loans eligible for Fast and Easy processing were not loans as to which income was required to be verified, since the borrower and credit characteristics qualified the borrower for waiver of standard documentation and verification of income. As a condition of the loan program, the borrower is asked to sign an Internal Revenue Service ("IRS") form 4506 that gives Countrywide the ability to obtain a copy of the borrower's tax return from the IRS. However, it was not the intent to obtain these tax returns on all loans, but only on a sampling of loans (after loan closing) for purposes of Quality Control monitoring of the program as required by Fannie Mae. We did such sampling for a number of years (80 loans per month). Based on the strong credit standards required for eligibility (see Question # 17 below), the Fast and Easy program outperformed traditionally documented loans. As a result, we and Fannie Mae agreed to discontinue the sampling in 2006. It is worth noting that consent to request tax returns is not obtained on traditional "low doc" or "no doc" loans because, by definition, such loans are processed without income verification.

15) As noted in the response to Question #14, the "Fast & Easy Loan" is a document and income verification waiver program. It is designed for borrowers with excellent credit FICO scores who, with their credit history and borrowing profile, have the ability to complete a full-documentation loan, but for whom the documentation requirements are waived due to their credit profile and the proposed loan terms.

The Government Sponsored Enterprises ("GSEs") both have proprietary Automated Underwriting Systems ("AUS"). These systems, like Countrywide's own AUS system, use statistically validated algorithms relating to borrower credit and loan transaction characteristics to predict loan performance and the probability of default. As highlighted in the Correspondent Lending Division presentation referenced in Question # 13, the product "rewards" high credit scored borrowers with a stated income, stated asset mortgage if the AUS determines that the borrowers' credit profile and proposed loan terms match the necessary characteristics of the algorithms to determine eligibility for the Fast & Easy product.

The GSEs are fully aware of the features of the program and it is not represented as a "full documentation" program. Similarly, to the extent such loans are securitized and sold to other investors, they are not sold or securitized as "full documentation" loans. For

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loans placed into securities, the disclosures applicable to such loans stated that a qualification for the product was that Countrywide had the right to obtain filed tax returns for the preceding two years and that Countrywide may waive documentation requirements for such loans. The disclosure also specified the percentage of the initial mortgage loans placed into the security that were processed under this program. Whole loan investors were fully aware of the features of the Fast and Easy program.

16) From 2004 to the present, 59 percent of Countrywide's 1st Lien Mortgages were originated with traditional full documentation (i.e., verifying income, assets, and employment). The actual percentages each year follow:

2004	62%
2005	57%
2006	54%
2007	62%
2008	67%

17) Fast and Easy is a current loan program, and its performance is subject to ongoing monitoring and review by Countrywide and Fannie Mae. As Countrywide informed the *Wall Street Journal* in connection with the April 30, 2008 article, borrowers who used the Fast and Easy program had a FICO score at origination of 749, compared to 714 for other prime conventional loan borrowers, and 93 percent of Fast and Easy loans were made to borrowers with FICO scores of 700 or higher. The average combined loan to value ratio ("CLTV") at origination on a Fast and Easy first lien loan was 75 percent.

As a result of these credit characteristics, Fast and Easy loans have outperformed more traditional types of loans that we have made. Countrywide's Fast and Easy loans had a total delinquency rate of 2.96 percent as of March 31, 2008, which is much lower than the level experienced by non-Fast and Easy prime conventional loans, which had a total delinquency rate of 4.42 percent. (This is the rate of loans that were at least one month late in making a payment, not a foreclosure rate.) As this product has and continues to perform well, Countrywide is not considering terminating the product.

18) The statement made to the *Wall Street Journal* concerning 'sampling' of loans was related to the form 4506. Verification of employment has been required prior to funding on all Fast and Easy loans since late 2006. A verbal verification of employment is also completed post funding on all loans selected as part of our internal Quality Control plans.

19) As indicated in my response to Question #17, the borrowers who accessed the Fast and Easy program had significantly better overall credit characteristics than borrowers using other prime conventional loan programs.

There have been individual cases where borrowers have misrepresented their income on their applications. This is true for Fast and Easy loans and it is also true for fully

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documented loan files. Borrowers sign their loan applications under penalty of perjury but not every borrower is truthful in his or her statements. We have no reason to believe such problems are systemic.

It has been our expectation that Fast and Easy products would perform better than other types of conventional prime mortgages, including fully documented loans. In fact, and as indicated in our response to Question #17, the Fast and Easy loans have outperformed non-Fast and Easy prime conventional loans. Countrywide's Fast and Easy portfolio had a total delinquency rate of 2.96 percent as of March 31, 2008 versus a 4.42 percent delinquency rate for non-Fast and Easy prime conventional loans.

Questions from Senator Richard J. Durbin

1a) Countywide agrees that trying to keep families in their homes is in everyone's interests.

1b) If a borrower cannot maintain the current payments on his or her mortgage loan, but is capable of making payments that make economic sense for the investor or servicer without creating significant new risk, then it is in everyone's interest to do what is necessary to move that borrower into a new or modified loan so that borrowers and their families can keep their homes.

2a) As of April 30, 2008, Countrywide serviced 8,977,694 loans. Of those loans, 0.7 percent of the portfolio or 65,732 are subject to some form of bankruptcy protection.

2b) Our experience has been that Countrywide's borrowers file for bankruptcy for the same reasons all debtors file for bankruptcy, and those factors have little or nothing to do with the conduct of their lender or their loan servicer. Historically, the primary reasons debtors file for bankruptcy are

(i) job loss;
(ii) illness; and
(iii) divorce.

Recent studies confirm this historical experience. The *Fayetteville Observer* in 2006 surveyed debtors in one county (Cumberland County, North Carolina): 28 percent said they filed for bankruptcy because of medical bills; 24 percent identified job loss/work reduction; 16 percent identified divorce/separation; and 8 percent listed the death of the spouse.

Similarly, in May 2007, the Institute of Financial Literacy published a study on the reasons people file for bankruptcy. While debtors did identify overextension of credit and unexpected expenses as factors, 46.3 percent of debtors in bankruptcy identified reduction of income as a factor that led to their filing for bankruptcy; 32.9 percent listed job loss as a factor; 30.9 percent listed illness/injury; and 15.9 percent listed divorce as a factor.

Countrywide's more recent analysis of the reasons our borrowers end up in foreclosure is consistent with the reasons for filing bankruptcy cited above. Our data shows that 59.1 percent of foreclosures are because of changes of income, including job loss; 11.8 percent were a result of illness; 7.2 percent cite divorce. Only 2.6 percent have cited payment change as the reason for foreclosure.

2c) We make every effort to keep our borrowers in their homes. In April 2008, Countrywide performed 18,947 home retention workouts, including over 15,000 loan modifications. In contrast, 6,948 loans involved a bankruptcy filing in April 2008.

We engage with our borrowers to find solutions to help them avoid either foreclosure or filing for bankruptcy. But in many instances, borrowers file bankruptcy to protect themselves from the weight of non-mortgage related debt or sometimes from the cumulative effect of all their debt. When a borrower files for bankruptcy, a lender's ability to enter into a loan modification or other home retention options is stayed for some period of time. Consequently, it is in both the borrower's and lender's best interests to arrive at a home retention solution without the borrower filing for bankruptcy.

3a) While it is not correct to say that it is impossible to account accurately for payments in a Chapter 13 bankruptcy, it is accurate to say that *automating* the process of accounting for Chapter 13 payments has proven difficult, and it remains largely a manual process. It is our understanding that this is an industry wide challenge – not a Countrywide-specific one. For this reason, Countrywide employs 26 full-time employees whose sole purpose is manually accounting for Chapter 13 payments. Countrywide believes its manual system is capable of properly accounting for payments under Chapter 13 plans. However, because the process is manual and cumbersome, mistakes may be made from time to time even with the best intentions, training and systems. When those mistakes are discovered, Countrywide acts quickly to rectify them.

3b) Over the years Countrywide has reviewed various computer systems that would allow us to automate the complete process of accounting for pre- and post-petition payments. To date, we have determined that using the available systems did not produce results that were more reliable than Countrywide's own manual system. Countrywide continues to evaluate ways to improve its systems including the use of new technology as it becomes available.

3c) As you described in your question, in a Chapter 13 bankruptcy, the borrower is responsible for making timely post-petition payments while any delinquency is paid incrementally by the bankruptcy trustee over a period of time through the plan. Generally, the amounts coming from the borrower must be credited against post-petition payments while the pre-petition amounts from the trustee must be credited against the

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delinquency. This process is made more complex by the irregular stream of funds received from trustees who do not have uniform processes for delivering payments. Trustees do not send checks on consistent dates and do not send them in consistent amounts. Further, the trustee often sends a single check to pay partial amounts on dozens (sometimes hundreds) of loans. These factors significantly complicate the accounting process.

I hope the above responses have addressed your concerns.

Respectfully,

Mary Jane Seebach for
Steve Bailey
Chief Executive for Loan Administration

Questions from Senator Charles E. Schumer

1. **In your estimation, what economic incentives exist for lenders, with respect to inducing a foreclosure?**

Lenders and servicers are required to advance money for fees, costs, taxes and insurance when a borrower/debtor stops paying. Most surveys estimate that lenders lose $40k on each foreclosure. It would seem that loss mitigation would provide an economic incentive of reducing the loss to investors and the financial community with the added benefit of keeping borrowers in their houses. Unfortunately, trustees continue to hear from debtors that they were unable to access loss mitigation programs to save their houses from foreclosure.

HUD counselors, debtors and their attorneys tell us of their inability to do short sales, loan modifications and loss mitigation. They tell us of waiting on the phone for hours or the inability to get answers from the servicers or their designees. We hear stories of having to fax documents numerous times to attempt to get the documentation to the "right" person. Debtors and their attorneys tell us of trying to comply with the servicers' requirements only to run out of time prior to the date of foreclosure if they do speak to someone. Part of the issue is that even as the borrowers are on a track to do loss mitigation, their house continues in the foreclosure process.

These problems could be the result of a number of different things- the lack of funding by servicers for adequate personnel and programs in the loss mitigation and bankruptcy areas, the stress on the current inefficient system, the debtors waiting and playing ostrich until the last minute to save their house or a pricing system that allows attorneys for GSE's such as Fannie or Freddie to be paid more for a foreclosure than for a successful loss mitigation.

Once the borrower is in bankruptcy, there is very little guidance for servicers on loss mitigation, Freddie and Fannie rules and regulations are less than a page while a loan is in bankruptcy, and what guidance there is- is confusing at best. This has caused many issues, not the least of which is the borrower's inability to use loss mitigation to save their homes during the bankruptcy.

For example, a retired military couple filed bankruptcy about 2 years ago through our office. Their mortgage is through the VA and they were about 10 months behind when they filed the bankruptcy. Their economic issues were due to medical bills for the wife, and they wanted to save their family home. After being in the bankruptcy for a year, the husband had additional medical expenses and they needed to reduce their payment to pay for their medicines which they had stopped purchasing upon filing the bankruptcy due to cost. We contacted the servicer for VA and asked if it would consider rolling part of the pre petition arrears onto principal to lower their payment to allow them to purchase their needed medicine. The servicer contacted VA and was advised VA would not consider any loss mitigation while they were in bankruptcy. I then contacted my contact at VA and was advised the same. This position will result in the couple losing their home as they cannot pay for the arrearage in full with their ongoing mortgage payment and still pay for the needed medicine within the five year time frame.

These issues are exacerbated by the fact that many of the subprime loans in question have private mortgage insurance. Under the terms of the PMI contract, the PMI carrier must approve the loss mitigation. Due to the losses they have incurred, we are told that the insurers are not agreeing to any form of loss mitigation. It appears the only way that these insurers can be forced to do loss mitigation is by court order- such as that in a bankruptcy court.

Trustees have begun trying to do loss mitigation thru the bankruptcy system with varying degrees of success. We have been successful doing loss mitigation for debtors with small local servicers of Freddie Mac loans. The trustees in Nashville and Memphis, Tennessee have begun a program where after the filing of the bankruptcy, debtors are routed to HUD counselors to try access a loss mitigation program which is then approved by the Bankruptcy Court. NACTT has and continues to work with Fannie, Freddie, VA and HUD to attempt to resolve these issues and institute programs- and have another meeting scheduled in June this year.

As a trustee, I want to believe that the servicers are not trying to induce foreclosures. But, the borrower's claims of the inability to access loss mitigation prior to a foreclosure, the inability to do loss mitigation in bankruptcy and the PMI insurers refusal to allow loss mitigation, force me to believe that a foreclosure must somehow be easier or more economical than spending the funds to have an efficient loss mitigation program that is adequately funded and staffed.

It is due to these continuing issues that the NACTT Executive Board chose to do something unprecedented- support legislation. This legislation allows the Bankruptcy Court to do the same sort of modifications in bankruptcy they do for corporate pension funds, vacation properties and farms- allow modifications of first mortgages in limited circumstances to attempt to resolve these problems. If the servicers, investors and attorneys for the servicers are unwilling or unable to staff the loss mitigation programs on a sufficient level to allow persons who want and can afford to save their houses to access the loss mitigation programs, then the system needs to be changed to allow the Bankruptcy Courts to do it for them.

2. What legislative options exist for addressing existing problems in the bankruptcy system?

There are a number of options and opportunities for legislative change.

- Every servicer and/or lender should be required to **provide notice** to the debtor, his attorney and the trustee **through the court when there is a payment change** for interest rate adjustments or escrow adjustments.
- Every servicer and/or lender should be required to **provide notice** to the debtor, his attorney and trustee **through the court of post petition costs, fees or advances assessed to the loan during bankruptcy** and the Bankruptcy **Court should have the clear jurisdiction to determine if they were reasonable and necessary, and to enter final orders that survive discharge or closing of a case.**
- Legislation should make clear that the **application of payments** by servicers and/or lenders should be **consistent with the terms of the plan** and provide for sanctions if misapplied payments are due to willful creditor abuse and cause material harm to the debtor.
- Legislation should make clear that servicers and/or lenders are required to **comply with the requirements of the Real Estate Settlement Procedures Act (RESPA)** in regards to the escrow accounts and provide for sanctions for the willful failure to comply during the pendency of the bankruptcy.

  Proposed language implementing these four proposals is attached.

These four changes will allow debtors to obtain their fresh start at the end of the bankruptcy without fear of unknown payment changes or unexplained fees or costs. The filing of the notices is a minimal cost to the servicer and will allow implementation of a nationwide solution instead of having to deal with the myriad of local rules and case law to reach the same conclusion.

• Specifically, what would be the effect of Congress's modifying 11 USC § 502(b) – the section that lays out when a court can disallow a claim brought by a creditor – to bar a creditor from collecting any claim it hasn't justified with documentation? Can you provide suggestions on how to craft such language?

- It is unclear under current law whether merely disallowing the claim when documentation is not provided voids the underlying lien between the debtor and the lender. Secured creditors are not required to file proofs of claim in a bankruptcy- and when there is an issue with perfection, they will chose not to file a claim.
- It used to be that secured creditors who did not participate in the bankruptcy process had their lien survive the bankruptcy and were able to collect against the property after the discharge. This was the clear law prior to the implementation of BAPCPA however the additional language to 11 USC 1325(a)(5)(b)(i)(I) states that the lien survives until either the lien is paid or the discharge is granted That means that it may be the case that if a creditors fails to file a proof of claim, and the lien is provided to the terms of the plan, the lien would be discharged without payment due to no proof of claim.

  Proposed language is attached.

• Likewise, how could Congress modify 11 U.S.C. § 524(i) to provide that a debtor can get recourse from a creditor's failing to follow the law on fees, at any point in a proceeding?

- As mortgages are not discharged at the end of the bankruptcy, similar language to 524(i) should be added to 11 USC §1326 to provide this type of relief.

  Proposed language is attached.

• How could Congress modify existing law to provide a scheme of sanctions for misconduct on the part of lenders or servicers? What conduct might Congress specifically proscribe as sanctionable? And what might an appropriate sanction be?

- Suggestions for modifications would be:
  - *Failure of servicers' attorneys to review proof of claims, motions and pleadings prior to filing.*
    - While currently covered under Federal Rules of Bankruptcy (Rule 9011), stronger language requiring a certification prior to the filing of the proof of claim or pleading similar to that required by a debtor's attorney would help resolve this issue.
    - Monetary sanctions and the ability to recover attorney fees would appear to be most effective sanction in these types of cases

  - *Servicers' addition of fees, costs or other charges without any recourse as to the reasonableness or necessity*
    - While this may be covered by Rule 2016 and 3001, legislation should statutorily require this - allowing sanctions to be recovered for failure to comply with same.

  - Servicers should be required to file with Bankruptcy Court any additional, fees, costs or advances for review of reasonableness and necessity during the life of the bankruptcy.
  - Sanctions should be tailored to the harm. Failure to file the notices, assessing additional fees or costs without notice, or assessing unreasonable fees, costs or advances should result in the denial of repayment to the servicer by the Bankruptcy Court. Systemic and willful behavior resulting in material injury should result in punitive sanctions.

- *Servicers' failure to properly account for and apply payments received under the plan.*
  - While may be covered by 11 U.S.C. 524(i), this is questionable and awkward at best. Legislation should statutorily require the servicer to properly apply the payments pursuant to the terms of the confirmed plan and allowing sanctions to be recovered for the failure to comply with same.
  - **It is questionable whether or not current computer systems are capable of properly applying payments according to the terms of the confirmed plan and this inability coupled with no notice of payment changes or post petition costs and fees results in problems in over 60% of the cases in our office.**
  - Sanctions should be tailored to the injury. Willful failure to properly apply payments resulting in material injury should result in punitive sanctions.

- *Servicer's failure to adequately inform the parties of payment changes leading to the inability to have the mortgage current at discharge*
  - Sanctions should be tailored to the injury. Failure to file these notices or provide notice should result in the denial of obtaining these increases by the Bankruptcy Court. Systemic and willful behavior resulting in material injury should result in punitive sanctions.

- *Servicers' failure to comply with federal regulations such as RESPA leading to the inability to have the mortgage current at discharge.*
  - Sanctions should be tailored to the injury. Failure to perform escrow analysis or comply with RESPA during the bankruptcy should result in the denial of obtaining any additional funds to reimburse same by the Bankruptcy Court. Systemic and willful behavior resulting in material injury should result in punitive sanctions with a private cause of action.
  - **At least 6 of the national servicers regularly do not analyze any loans in bankruptcy for changes in taxes and insurance and provide no notice to the court, the debtor or the trustee of this deficiency during the bankruptcy.** We regularly see the servicer demand thousands of dollars at the end of the bankruptcy for these increases. If the servicers had timely analyzed these loans and advised our office, the court and debtor's attorney of these increases during the bankruptcy, the servicer would have had them repaid timely and this would no longer be an issue.
  - Servicers' claim that the only party who has enforcement authority on this issue is HUD. **This is a systemic issue that has to be resolved with a private cause of action to force all servicers to comply with this RESPA provision.**

Questions from Senator Richard J. Durbin

1. In order to address the challenge of mortgage companies imposing unreasonable and inappropriate fees in bankruptcy, it appears a clean and sensible approach would be to require that debtors and trustees be given adequate notice of all fees imposed upon debtors in bankruptcy.

Do you agree with this approach?

Yes- this is one of the suggestions in the NACTT best practices. I support legislation that requires the servicer to file with the Bankruptcy Court a notice of the fees, costs and advances during the bankruptcy as well as a notice of any payment change. This allows all parties- the trustee, debtor, debtor attorney, servicer and servicer attorney – to be on the same playing field and avoids the issue of whether the fees were reasonable and necessary or a whether a document showing payment changes were "fabricated" or "recreated" or "lost". This practice advocates communication between the parties and brings "sunshine" into the currently "murky" area of post petition fees, costs and advances during a bankruptcy.

Additionally, I believe that the Bankruptcy Court has to be given clear statutory jurisdiction over the reasonableness and necessity of the fees, costs and advances during the bankruptcy. In litigation over these issues, servicers and their attorneys claim that the Bankruptcy Court has no jurisdiction over the post petition fees and costs and that requiring these notices- even to just be sent to the trustee and the debtor's attorney- is an improper modification to their mortgage under §1322(b). Some courts have ruled in the servicers' favor causing this to become a contested issue.

As these fees, payment changes and advances affect the amount to be paid to unsecured creditors in many of the bankruptcies; these items clearly need to be identified, filed with and reviewed by the Court to ensure they are not unreasonable and inappropriate.

I believe that a provision needs to be added to §1322(b) that specifically states that the Bankruptcy Court has jurisdiction and that the requirement to file these notices is not an improper modification of the mortgage to effectuate your approach.

Proposed language is attached.

2. I have introduced S.2136, the Helping Families Save Their Homes in Bankruptcy Act, which has been reported out of the Senate Judiciary Committee. S. 2136, as reported, would require adequate notice of bankruptcy fees imposed by mortgage companies, and would allow a bankruptcy judge to waive prepayment penalties on home mortgages. It would do so by amending 11 U.S.C. 1322(c) so that it would read as follows (with new paragraphs in italics):

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law-
(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law;
(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which

the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325 (a)(5) of this title;

(3) the plan need not provide for the payment of, and the debtor, the debtor's property, and property of the estate shall not be liable for, any fee, cost, or charge, notwithstanding section 506(b), that arises in connection with a claim secured by the debtor's principal residence if the event that gives rise to such fee, cost, or charge occurs while the case is pending but before the discharge order, except to the extent that-

(A) notice of such fees, costs or charges is filed with the court, and served on the debtor and the trustee, before the expiration of the earlier of

(i) 1 year after the event that gives rise to such fee, cost, or charge occurs,' or

(ii) 60 days before the closing of the case,' and

(B) such fees, costs, or charges are lawful, reasonable, and provided for in the agreement under which such claim or security interest arose;

(4) the failure of a party to give notice described in paragraph (3) *shall be deemed a waiver of any claim for fees, costs, or charges described in paragraph* (3) *for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a violation of section 524(a)(2) of this title or, if the violation occurs before the date of discharge, of section 362(a) of this title,' and*

(5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the principal residence of the debtor.

What are your views on this legislative language?

I think that this legislation is a needed solution to a significant problem in Chapter 13 bankruptcies with sensible sanctions for non compliance.

Additionally, servicers should support this type of legislation- it is similar to that language with which servicers agreed in the best practices. The requirement of filing these notices will allow the servicer to institute a nationwide practice, certainly simpler than their current attempts to comply with the myriad of local rules and plans concerning this issue.

I do have a concern over the reference to §524(a)(2). Mortgages are not discharged at the end of the bankruptcy. By placing the payment application, violation and sanctions under 524- there is an argument that these provisions would not apply after discharge to the non discharged mortgage.

A solution would be to add a similar provision to 11 U.S.C. §1326 which would apply to all creditors including mortgage holders.

Proposed language is attached.

3. I am interested in the role that limitations in the computer systems of mortgage servicers might play in assessing unwarranted fees. I understand that most national mortgage servicers use a program called the Mortgage Servicing Platform, a.k.a. the Fidelity National Information System. In a case last year, *In re Nosek,* 363 B.R. 643 (Bkrtcy. D. Mass. 2007), Ameriquest stated the following in its opening brief on appeal: "At present, no computer program exists that is capable of accounting for payments by Chapter 13 borrowers under the bifurcation scheme that is usually used in most Chapter 13 cases." As I understand it, this "bifurcation scheme" to which Ameriquest alludes is simply the fact that once a bankruptcy plan is confirmed, all payments made to new monthly liabilities should be

applied against those new liabilities rather than against older pre-bankruptcy debt, since that older debt is handled separately as part of the lender's claim.

a. Chapter 13 has been on the books for 30 years. To the extent of your knowledge, is it accurate today that "no computer program exists that is capable of accounting for payments by Chapter 13 borrowers"?

This continues to be the explanation given by servicers for payment application problems in a Chapter 13.

I am aware of at least three separate systems including Fidelity/MSP used by servicers with additional "wrap around" programs to try to properly credit the payments. Countrywide, according to the brief filed in a case in Texas uses a proprietary *"AS400 accounting system that is maintained and updated manually in order to track and allocate borrower and trustee payments post-petition in addition to Countrywide's computerized Master Loan History. The Master Loan History records every debit and credit to a borrower's loan... It does not distinguish between pre- and post-petition debits and credits."*

The bifurcation system that you describe is correct. The computer programs should work as follows:

As of the date of the bankruptcy, the mortgage should be considered "current" by the servicer for the purposes of the bankruptcy.

As of the date of filing, the servicer should run an escrow analysis. The prepetition arrearage claim filed with the court should include the escrow shortage amount from that analysis for the next 12 months as well as any fees, costs, advances and interest due and owing as of the date of the filing of the bankruptcy. That balance should be offset by the payments by the trustee on the pre petition arrearage claim with a declining balance.

The post petition ongoing mortgage payments would then be paid and credited each month when received. The payments, made on time, would not be subject to late fees or inspections or show as delinquent in the servicers' system.

This inability to properly post payments is an ongoing, very real problem. The servicers claim that the programs can track pre petition payments to the arrearage claim and the post petition payments to the payments due after filing with the proper training, computer settings and internal controls. That does not appear to actually be what is really happening due to the continuing issues and problems in this area.

I should note that the 200 or so Chapter 13 Trustees, using a variety of computer software programs, with much smaller capital outlay, do manage to successfully disburse and track these payments without an issue.

b. If this is accurate, do you believe this is a case of willful neglect on behalf of the servicers so that they can assess and collect more fees?

Bankruptcy is not a division within servicing that makes money. The economic reality is that the cost to make the needed changes to the computer software is not going to be spent by the lender or software vendor until it is forced. Additionally, software is only as good as the people using it. Issues with training, lack of communication between bankruptcy and the escrow departments and absence of auditing and other internal controls over the payment application processes causes real issues in a Chapter 13.

Currently, our office finds issues with over 60% of all mortgages prior to the discharge process. Many times there are fees, costs or advances that our office was not advised of, increases in taxes and insurance that were not disclosed or payments that were misapplied by the servicer. As our office makes the ongoing mortgage payments, we have the ability to provide cancelled checks and the date of the payment to prove the payments were made timely and not credited correctly to try to resolve these issues.

Unfortunately, debtors generally do not have this type of documentation. I personally believe that until the systemic payment application issues are resolved, all payments to mortgage companies should be made by the trustee to ensure that the debtors are not taken advantage of.

The economic reality is that until the litigation costs and sanctions cost the servicer more than the change in the software, procedures and internal controls, the industry has little incentive to change the status quo.

Questions from Senator Jeff Sessions

1. You stated that while your judicial district vigorously enforces bankruptcy abuses, other districts do not due to ambiguity in current law regarding what documentation is properly required.

a. Identify areas in which there is latent ambiguity that needs to be addressed in order to promote uniform compliance with current law.

Language in 11 U.S.C. §1322(b)-

In our litigation against Ameriquest, (In re Laskowski), its attorney claimed that there was no obligation for Ameriquest to account for payments received during a Chapter 13 plan. The argument was that under 11 U.S.C. §1322(b)(2) and (5), a plan may not modify the terms of its mortgage- which includes how the payments are to be applied. Ameriquest cited *In re Good*, 207 B.R. 686 (Bankr. D. Idaho 1997) and quoted as follows:

"However the Code also does not allow her to modify Creditor's rights under its note and deed of trust. Therefore, the Court concludes that the parties are bound by their contracts concerning how default payments must be applied." Id. at 689.

Language in 11 U.S.C. §524(i)

As the mortgage is not discharged at the end of the bankruptcy, the provisions of 11 U.S.C. §524(i) may not apply to the mortgage servicer or lender after discharge and do not apply to incorrect payment application while the bankruptcy is still pending.

Language in 11 U.S.C. §1327(b)

If the real estate or property is vested back in the debtor as of confirmation, mortgage servicers take the position that the trustee has no standing to bring an action for post petition costs and fees as the real estate is no longer subject to the bankruptcy court jurisdiction. *Telfair v. First Union Mortgage Corp*, 216 F3d 1333 (11th Cir. 2000)

Language in 11 U.S.C. §362(a)
The automatic stay does not preclude the mortgage servicer from applying payments in accordance with the underlying note. *Mann v. Chase Manhattan Mortgage Corp*, 316 F3d 1 (1st Cir. 2003)

Language in Bankruptcy Rule 2016
This rule needs to be strengthened to provide clear jurisdiction of the Bankruptcy Court to review and approve for reasonableness any fees or costs for any creditor seeking payment from the bankruptcy estate. *Williams v Chase Manhattan Mortgage Corp.,* 2005 U. S. District LEXIS 45606.

b. What requirements are currently available that, if followed as the law intended, could provide strengthened enforcement from bankruptcy judges and trustees, absent differing interpretation from district to district?

Judges and trustees do not know what the law intended. We can only apply the law as written.

Bankruptcy Rule 3002(a) does not require a secured creditor to file a proof of claim. Section 501 should be clarified to require secured creditors to file proofs of claim in a Chapter 13.

Some jurisdictions do not permit the mortgage lender or servicer to file a copy of the mortgage or note showing their perfected status. This is clearly contrary to Rule 3001(c) and (d). The filing of a copy of the mortgage documents should be mandatory.

Lastly-I would encourage the Rules committee to create a national proof of claim form for use by the mortgage servicer. Additionally, Federal Rules of Bankruptcy Procedure 3001 should be amended to provide a statement of accounting all components of the claim including costs advances, fees, charges, pre petition interest, pre petition late fees. This would promote national consistency and keep everyone on the same page.

c. Do you think there should be new laws to impose sanctions on creditor attorneys for filing erroneous proofs of claim?

Yes- the law should also be specific as to what is to be included in the mortgage proof of claim to help make the system more uniform throughout the country. Additionally, the certification on the proof of claim should be strengthened.

While currently covered under Rule 9011, the Rule requires, in part, that an attorney make "an inquiry reasonable under the circumstances" before making representations to the court. If reasonable inquiry is not conducted, the court may impose appropriate sanctions against the violating attorney. Some courts have found that the local counsel meets the reasonable inquiry requirements of Rule 9011 if they rely on the forwarding attorney's information without a separate inquiry.

In many jurisdictions, local counsel appears or files Motions for Relief from Stay based upon a referral or affidavit from a "national" law firm. This results in the local counsel having little, if any, information about the case when they appear in court, no duty to independently review the document or pleading prior to filing, and no authority to solve disputes.

Additionally, under Rule 9011(c)(2)(B), if the attorney withdraws the motion prior to the hearing, there can be no sanctions levied by the Court. Unfortunately, some cases continue to arise where a Motion for Relief is filed based on the creditors' incorrect records, an objection is filed by the Trustee or Debtor's counsel, and then the Motion is withdrawn. Consequences to the debtor attach upon the filing of even an improper Motion for relief from stay under 109(g)(2). Additionally, there have been instances where the debtors loan is assessed these attorney's fees by the servicer even though the motion for relief had no basis. A mistake is surely not subject to sanctions; however, when it rises to the level of a systemic problem or abuse it needs to be addressed and sanctions should be able to be imposed- even if the Motion is withdrawn.

Because of this, I believe an additional requirement is warranted- as it is to the debtors attorneys after the implementation of BAPCPA- similar to that in 11 U.S.C. §526(a)(2). This would not allow the creditor attorney to make any statement, or counsel or advise any creditor to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the exercise of reasonable care should have been known by such attorney to be untrue or misleading.

Monetary sanctions and the ability to recover attorney fees would appear to be the best sanctions in these types of cases to stop these continuing abuses.

2. Professor Porter states in her written testimony that the USTP should compel private trustees to review and object to proofs of claim in Chapter 13 cases. Do you support such a proposal?

Currently the Code, under 11 U.S.C. §704(a)(5) and §1302(b)(1), already requires Trustee to review a proof of claim if a purpose would be served. The Trustee handbook mirrors this requirement.

If the Code does not compel the filing of documentation, local rules will control and trustees and debtor's attorney will be unable to review the documentation that Professor Porter suggests. In some jurisdictions, local rules prohibit the filing of the documentation and in those jurisdictions it is impossible for the debtor's counsel or trustees to review the documentation that as you and Professor Porter suggest.

In most jurisdictions, there are items on the proof of claim that the trustee should review. This review should include verifying the name of the claimant. Such review should also encompass the amounts asserted in the proof of claim and the components making up those amounts. With adequate detail, the Trustee can then indentify those portions of the POC that merit additional inquiry. The Trustee is not in the position to determine if the principal, interest or costs advanced are correct at the time of filing. Only the debtor has the knowledge to verify the accuracy of those amounts.

An organization that I am a member, NACTT, has embarked on a program of training trustees and staff on the appropriate way to administer mortgages in the Chapter 13 bankruptcy. Trustees have advised me and my own experience supports that errors and issues are increasing. Our office is able to find these issues and successfully protect the borrower against the unauthorized charges because we make every post petition mortgage payment and every pre petition arrearage payment absent good cause shown. We can then rely upon our records, our payment histories, and our records showing the payment changes to combat these abuses.

In many jurisdictions, this is not the case. When a trustee does not make the ongoing mortgage payments, he cannot determine if the escrow statements are correct or if the payments have been made each month, on time as required by the plan.

Please note trustees are paid a fixed amount- they make no additional compensation if they administer 2000 or 20,000 cases, pay or don't pay mortgages through the plan or live in New York City or South Bend, Indiana. My personal opinion is that the only way to bring a modicum of accountability to the system and hold the mortgage servicers and lenders to the terms of the Bankruptcy Code is to require all mortgages to be paid through the Trustee's office. Requiring all payments to be made thru the trustee, provides the mechanism and oversight that the debtors and creditors are complying with the terms of the plan in all respects.

In those districts where the Trustee cure the mortgage arrears and Debtors pay ongoing mortgages directly, verification of payments may still be attempted, but it may incur a long involved process. Nevertheless, servicers and lenders should be held accountable and subject to the Bankruptcy Court's jurisdiction on appropriateness of fees and charges.

To fix the system, we have to change the system. My personal view is that Trustees should pay the ongoing mortgage, review mortgage proofs of claim, escrow statements and establish a process to verify that mortgages are current, with no outstanding fees, costs or negative escrow at discharge.

Lenders can then verify the payment in their systems with trustee computer databases on the Internet. They can verify the payments received from trustees and the application of those payments with their computer systems. There will be no more "he said, she said" as to whether or not a payment was made, the date of the payment or whether or not the lender can verify the payment was properly applied.

Debtors are being harmed and their fresh starts denied with the current process. They receive demands from the servicer after discharge for the fees, costs and undisclosed increases in taxes and insurance. They sometimes pay these fees, losing faith in the judicial and bankruptcy system that has failed them. They sometimes give up, allowing their houses to go back to the lender as they see a never-ending battle with the mortgage lender. This needs to stop.

Proposed language is attached.

<u>SUGGESTIONS FOR AMENDMENTS TO BANKRUPTCY CODE FROM DEBRA MILLER</u>

SECTION 1. DOCUMENTATION OF CLAIMS

(A) Section 502(b) of title 11, United States Code, is amended—

(1) in paragraph (8), by striking "or" at the end;

(2) in paragraph (9), by striking the period at the end and inserting "or"; and

(3) by adding at the end the following:

" (10)(A) the claim is an asserted secured claim and is not accompanied by—

(i) an itemized statement of any interest or other charges, if the amount of the claim includes interest and other charges in addition to the principal amount of the claim

(ii) a copy of the writing, or if the writing has been lost or destroyed, an affidavit that explains the circumstances of the loss or destruction, if the claim is based on a writing;

(iii) evidence that the security interest has been perfected, if a security interest in property of the debtor or the estate is claimed;

(iv) if the claim has been transferred, evidence of transfers establishing that the person filing the claim is a creditor of the debtor; and

(v) for a claim purportedly secured by a debtor's principal residence for which an escrow account exists, a copy of an escrow account analysis as set forth in section 10 of the Real Estate Settlement Procedures Act (12 U.S.C. § 2609) that is current as of the date of that the petition for bankruptcy relief was filed.

(B) the person who filed the claim fails to provide the documentation required under subparagraph (A) not later than 21 days after the date of notice that such documentation was not submitted."

SECTION 2. APPLICATION OF PAYMENTS IN CHAPTER 13

Section 1326 of title 11, United States Code, is amended by adding at the end the following:

"(e)(1) A creditor or its agent who receives payments made by the trustee or the debtor during the bankruptcy shall credit all payment to the debtor's account as of the date of receipt. Notwithstanding the underlying agreement and applicable nonbankruptcy law, a payment made by the trustee under the plan for the maintenance of payments made pursuant to Section 1325(b)(5) of this Title while the case is pending under a confirmed plan shall be treated as timely received and the debtor's account shall not be assessed any late fee or other default charge as the result of a delay in payment by a trustee.

(2) Any person materially injured as the result of any act to collect, including the filing of any motion or pleading that results from the wilful failure of a creditor or its agent to apply or credit payments in the manner required under the plan confirmed under this title, unless the order confirming the plan is revoked, shall recover actual damages including costs and attorneys fees and in appropriate circumstances punitive damages.

Section 1306 of title 11, United States Code, is amended by adding to the end the following:

"(c) During the pendency of a case under this chapter, the stay imposed by section 362 shall continue to apply to property of the estate which has revested in the debtor to the same extent as it does other property of the estate."

SECTION 3. DISCLOSURE OF FEES

Section 1322(c) of title 11, United States Code, is amended—

(1) in paragraph (1), by striking "and" at the end;

(2) in paragraph (2), by striking the period at the end and inserting "; and"

(3) by adding at the end the following:

"(3) the plan need not provide for the payment of and the debtor, the debtor 's property, and property of the estate shall not be liable for, any monthly payment change, fee, cost, or charge, notwithstanding section 506(b), that arises in connection with a claim secured by the debtor's principal residence if the event that gives rise to such payment change, fee, cost, or charge occurs while the case is pending but before the discharge order, except to the extent that-

(A) notice of such payment change, fees, costs or charges is filed with the court, and served on the debtor and the trustee, before the expiration of the earlier of

(i) 1 year after the event that gives rise to such fee, cost, or charge occurs; or

(ii) 60 days before the closing of the case; and

(B) such payment change, fees, costs, or charges are lawful, reasonable, and provided for in the agreement under which such claim or security interest arose;

(4) the failure of a party to give notice described in paragraph (3) shall be deemed a waiver of any claim for payment changes, fees, costs, or charges described in paragraph (3) for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a violation of section 524(a)(2) of

this title or, if the violation occurs before the date of discharge, of section 362(a) of this title; and (5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the principal residence of the debtor."

SECTION 4 COMPLIANCE WITH RESPA DURING BANKRUPTCY

Section 1322(c) of title 11, United States Code, is amended by adding at the end the following:

"(5) Any servicer as defined by 12 USC 2605(i)(2) shall conduct the analysis defined in section 10 of the Real Estate Settlement Procedures Act (12 U.S.C. § 2609) as of the time of the order for relief and annually thereafter or more often if required by 12 USC 2601 et seq. and

(A) each analysis shall be filed with the bankruptcy court and served upon the debtor, debtor's counsel if any and the trustee within 21 days of such analysis; and

(B) failure of the servicer to conduct the analysis and or file the analysis with court shall be deemed a waiver of any additional sums due or owing pursuant to that analysis and any attempt to collect such amount shall constitute a violation of section 524(a)(2) of this title or, if the violation occurs before the date of discharge, of section 362(a) of this title.

SECTION 5 - PRESUMPTION THAT PAYMENTS ARE MADE BY TRUSTEE

Section 1326(c) is amended -

(1) By striking "Except as otherwise provided in the plan or in the order confirming the plan, the" and inserting "The";

(2) by striking the period at the end of the subsection and inserting "unless the court finds it to be in the best interests of the debtor, the creditors, and the trustee that the debtor or other party make payments to creditors under the plan."

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SECTION 6 – FILINGS WITH THE COURT

Section 501 of title 11, United States Code is added as follows:

"(f)(1) The signature of any party on a proof of claim filed under this section or on a pleading seeking to disallow a claim pursuant to section 502 shall constitute a certification that such person has performed a reasonable investigation into the circumstances that gave rise to the claim (including all fees, costs, or charged included in the claim) or pleading and has determined that the claim or pleading is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law.

(2) In addition to any other remedies provided by law, any party found to have violated the provisions of (f)(1) shall be liable for actual damages and costs, including attorneys fees, and, in appropriate circumstances, punitive damages."

THE UNIVERSITY OF IOWA

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

May 28, 2008

Mr. Marco De León
Legislative Correspondent
314 Hart Senate Office Building
Washington, DC 20510

Mr. De León:

I am pleased to provide the following responses to the written questions of committee members following the May 6, 2008 hearing, "Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?

Sincerely,

Katherine Porter
Associate Professor of Law

Questions from Senator Charles E. Schumer

1. In your estimation, what economic incentives exist for lenders, with respect to inducing a foreclosure?

RESPONSE: This question asks about "lenders." Most recent residential mortgages have been securitized. If this has occurred, the originating lender usually will no longer have any significant interest in the loan. The holder of the loan would be a trust, on behalf of a diffuse group of investors in mortgage-backed securities. To the best of my knowledge, the investors, as holder of a loan, do not have any interest in inducing a foreclosure. Given the focus of the hearing, I assume that the question means to refer to "servicers" rather than "lenders." Servicers do have a financial incentive to impose additional fees on consumers, and these fees can push consumers into foreclosure. Under the terms of most pooling and servicing agreements, servicers are permitted to retain default fees that consumers pay. For example, if a borrower chronically pays late, the servicer earns additional revenue. In this way, a borrower's default can boost a servicer's profits. A significant fraction of servicers' total revenue comes from such retained fee income. Costs for default services, such as property inspections and appraisals are also charged to borrowers' accounts. In some instances the costs of services provided by third-party vendors may be marked-up by the servicer. This practice results in the borrowing paying additional costs while the servicer earns additional profits. In other cases, default services are performed by the servicer's own subsidiaries, which gives the servicer an incentive to order such services more frequently than may be necessary and reasonable. These fees and costs can overwhelm the consumer and induce a foreclosure. Once a mortgage is in foreclosure, servicers' incentives are to charge as many fees as possible. Such foreclosure fees and costs are normally paid first, before any money from the sale of the foreclosed home is distributed to investors. Thus, servicers have much to gain and little to lose from piling on or bloating such fees and costs. Servicers use these foreclosure and default fees and costs to boost their profits and offset the extra costs of servicing a loan in default or foreclosure. The accumulation of these fees and costs makes it hard, or impossible, for a consumers to cure a default on his or her loan and can lead to foreclosure.

2. What legislative options exist for addressing existing problems in the bankruptcy system?

   - Specifically, what would be the effect of Congress's modifying 11 U.S.C. § 502(b) -- the section that lays out when a court can disallow a claim brought by a creditor — to bar a creditor from collecting any claim it hasn't justified with documentation? Can you provide suggestions on how to craft such language?

RESPONSE: I recommend amending 11 U.S.C. § 502(b) to add the failure to provide documentation as a basis for disallowing a claim. This would ensure that only creditors that have valid debts are paid, and that such payments are for only the lawful amount of the debt. Under current law, a debtor or other party that objects to a claim usually is required to allege a specific substantive basis for claims disallowance that is listed in section 502. Most courts overrule objections based on the failure to attach required documentation, despite the reality that without the documentation, debtors or other parties `cannot understand whether a creditor has a legitimate claim and cannot verify the accuracy of the amount of such claim. A moderate approach would be to disallow claims that lack documentation only after the creditor has received notice that such documentation was not submitted and the creditor still has failed to prove its claim. The effect of disallowing a claim would be to eliminate the obligation of the debtor to pay the claim, or the part of the claim, that was disallowed. This is not a new or radical outcome but rather is the logical result of a failure of evidentiary proof. If a creditor attempted to foreclose pursuant to state law and a debtor contested the foreclosure, the creditor would be required to prove the validity of the foreclosure. The creditor would need to show that a debt existed by putting the promissory note in evidence, to document that it had a security interest in the debtor's home by putting the mortgage in evidence, and to establish the amount of the debt by putting an accounting of principal, interest, fees, and charges in evidence. Amending section 502(b) would ensure that bankruptcy law gives homeowners the same level of protection from losing their homes that state law does. Given the specific laws in Chapter 13 that are intended to help struggling families save their homes, it is critical that the bankruptcy system cease to be a venue for taking advantage of homeowners and instead become a safe harbor in which families can repay their creditors without being subjected to abusive practices.

I offer a proposed amendment to section 502(b) below. The legislative language conforms to the language of existing Rule 3001 to avoid imposing additional burdens of documentation on creditors beyond the existing rules for a copy of the writing, a copy of the security interest, and an itemization. The proposed statute does address two additional documentation concerns. Several courts have expressed concern that creditors lack standing to file a claim because they do not and cannot show they are either the creditor of the debtor, or an agent of such creditor. Some courts have implemented a burdensome process of setting a hearing for each claim that is not supported with appropriate assignments to show the basis upon which the claimant would have any interest in being paid on the claim. This concern exists not only for mortgage loans but also with regard to unsecured claims that are frequently sold to companies that purchase distressed debt. Further, as Ms. Miller and Mr. Bailey testified at the hearing, there are substantial problems with the escrow accounts of loans in bankruptcy. The proposed language would clarify that if an escrow account exists for the debt, that the claim must contain a copy of an escrow analysis. This will expose and deter the practice of "double-dipping" with regard to escrow accounts by including the amount of any escrow deficiency as arrearage in the claim but then also calculating and collecting the ongoing mortgage payments in an amount that corrects any escrow deficiency.

The proposed language gives creditors ample opportunity to comply with the documentation rules that govern proofs of claims. Rather than disallowing claims that are not supported by documentation, the proposed language requires debtors, trustees, or a party in interest to provide notice to the person who filed the claim that the claim lacked required documentation. The claimant is then given a 21-day window to provide the missing documentation. The length of this safe harbor mirrors the existing provisions of Rule 9011, which are not adequate to address problems with proofs of claim because most claims are not signed by attorneys. Likewise, section 707(b)(4) is not adequate to address problems with proofs of claim because it also only applies to attorneys (and moreover only applies in Chapter 7 cases).

I recommend amending section 502(b) by adding the following:

"(10)(A) such claim is not accompanied by—

(i) an itemized statement of any interest, fees, costs, or other charges, if the amount of the claim includes interest or other charges in addition to the principal amount of the claim;

(ii) a copy of the writing upon which the claim is based, or if the writing has been lost or destroyed, an affidavit that explains the circumstances of its loss or destruction, if the claim is based on a writing;

(iii) evidence that the security interest has been perfected, if a security interest in property of the debtor or the estate is claimed;

(iv) if the claim has been transferred, evidence of transfers establishing that the person filing the claim is the creditor holding the claim against the debtor;

(v) for a claim secured by a security interest in property that is the debtor's principal residence for which an escrow account exists, a copy of an annual escrow account statement as described in section 10 of the Real Estate Settlement Procedures Act (12 U.S.C. § 2609) for the most recent period before the date of the filing of the petition and for the period beginning with the date of the filing of the petition, and

(B) if the person who filed the claim fails to provide the documentation required under subparagraph (A) not later than 21 days after the date of notice that such documentation was not submitted."

- Likewise, how could Congress modify 11 U.S.C. § 524(i) to provide that a debtor can get recourse from a creditor's failing to follow the law on fees, at any point in a proceeding?

RESPONSE: I believe that section 524(i) is inadequate to address the problem of fees and costs assessed during a bankruptcy cases for two reasons. First, section 524(i) only speaks to the application of payments, not the assessment of default fees and costs. Second, section 524(i) provides an ineffective remedy because it is available only when and if the debtor receives a discharge (which generally requires completion of a chapter 13 plan). The problem is that creditors frequently assess or attempt to collect default fees and costs during the pendency of a bankruptcy case. In many cases, such fees and costs arise only because the creditor fails to credit the payments properly as required by the order confirming the bankruptcy plan. In turn, these additional fees and costs cause the debtor to fail in chapter 13 and deprive the debtor of an action under 524(i). Section 1326 governs plan payments in Chapter 13, and I recommend adding language to that section that clarifies that creditors have a duty to follow court orders that confirm Chapter 13 plans and to apply all payments received in accordance with such a confirmed plan. At minimum, debtors should be protected from any act to collect that is the result of the misapplication of payments, including

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unwarranted motions for relief from stay. By incorporating the existing bankruptcy stay, the proposed language gives courts the benefit of existing law to guide them on the appropriate sanction, if any, that should be imposed if creditors attempt to collect fees or costs that should not have been assessed if the confirmed plan had been followed.

I suggest amending section 1326 by adding at the end the following:

> "(e) If a plan proposes to cure a default on a claim secured by a security interest in property that is the debtor's principal residence--
>
> (1) Payments made by the trustee or the debtor under the plan toward arrearages shall be immediately credited and applied upon receipt to the arrearages in an allowed claim or in a confirmed plan, as ordered by the court; and
>
> (2) Payments made by the trustee or the debtor for the maintenance of payments made pursuant to section 1322(b)(5) of this title shall be immediately credited and applied under the terms of the underlying agreement and applicable nonbankruptcy law as if any arrearages being paid separately under the plan do not exist.
>
> (3) Any person materially injured as the result of the willful failure of a creditor or its agent to credit or apply payments in the manner required under a plan confirmed under this title or by this subsection, unless the order confirming the plan is revoked, shall recover actual damages, including costs and attorneys fees, and in appropriate circumstances, punitive damages. Notwithstanding any other provision of law, the court may award such damages before or after the closing of the case."

To ensure that this language is enforceable in all jurisdictions, I recommend amending Section 1306 of title 11, United States Code, to add to the end the following:

> "(c) During the pendency of a case under this chapter, the stay imposed by section 362 shall continue to apply to property of the estate which has revested in the debtor to the same extent as it does other property of the estate."

- How could Congress modify existing law to provide a scheme of sanctions for misconduct on the part of lenders or servicers? What conduct might Congress specifically proscribe as sanctionable? And what might an appropriate sanction be?

RESPONSE: There are several ways that Congress could impose sanctions on creditors who engage in misconduct. One option is to amend section 105 of the Bankruptcy Code to provide a right of action in favor of debtors and panel trustees to ask the court to award actual damages, including costs and attorneys fees, and in appropriate instances, punitive damages, when a creditor has failed to support its claim as required by Rule 3001, willfully misapplied payments received during a bankruptcy case, or willfully assessed impermissible or undisclosed fees. Such a sanction provision could also incorporate a statutory damage provision. Given the large size of mortgage loans and the scale of the servicing industry, the minimum amount of statutory damages that I believe would be effective is $10,000. Another approach is to implement the amendments to section 502 and section 1326 that I recommend above. The addition of such sections would incorporate a sanction to deter creditors from misconduct by using existing bankruptcy law such as the discharge injunction and the automatic stay. One benefit of such an approach is that debtors, trustees, creditors, and courts are already familiar with those provisions so that implementation would be likely to proceed quickly.

Questions from Senator Richard J. Durbin

1. In order to address the challenge of mortgage companies imposing unreasonable and inappropriate fees in bankruptcy, it appears a clean and sensible approach would be to require that debtors and trustees be given adequate notice of all fees.

Do you agree with this approach?

RESPONSE: I agree that the disclosure of all fees and charges that arise during a bankruptcy case should be fully identified and disclosed. This notice should be filed with the bankruptcy court so that all parties in interest, including debtors and trustees, but also the U.S. Trustee, other creditors, and the bankruptcy court, have the opportunity to review these charges. I do not believe, however, that mere disclosure is sufficient. If a party attempts to impose fees or charges that are not warranted by the mortgage contract or by law, then the mere fact that these fees were disclosed does not, in my mind, create a defense to such misbehavior. Creditors who attempt to collect fees that are not permitted by law should not be allowed to "cleanse" these fees on the ground that they were disclosed. Like all parties in a legal proceeding, creditors should be held to a duty to use the court system only for legitimate purposes and not to overcharge and gain unfair advantage.

2. I have introduced S.2136, the Helping Families Save Their Homes in Bankruptcy Act, which has been reported out of the Senate Judiciary Committee. S. 2136 as reported would require adequate notice of bankruptcy fees imposed by mortgage companies, and would allow a bankruptcy judge to waive prepayment penalties on home mortgages. It would do so by amending 11 U.S.C. 1322(c) so that it would read as follows (with new paragraphs in italics):

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law-
(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law;
(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325 (a)(5) of this title;
(3) the plan need not provide for the payment of and the debtor, the debtor 's property, and property of the estate shall not be liable for, any fee, cost, or charge, notwithstanding section 506(b), that arises in connection with a claim secured by the debtor's principal residence if the event that gives rise to such fee, cost, or charge occurs while the case is pending but before the discharge order, except to the extent that-

> *(A) notice of such fees, costs or charges is filed with the court, and served on the debtor and the trustee, before the expiration of the earlier of*
>
> > *(i) 1 year after the event that gives rise to such fee, cost, or charge occurs; or*
> > *(ii) 60 days before the closing of the case; and*
>
> *(B) such fees, costs, or charges are lawful, reasonable, and provided for in the agreement under which such claim or security interest arose;*

(4) the failure of a party to give notice described in paragraph (3) shall be deemed a waiver of any claim for fees, costs, or charges described in paragraph (3) for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a violation of section 524(a)(2) of

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this title or, if the violation occurs before the date of discharge, of section 362(a) of this title; and (5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the principal residence of the debtor.

What are your views on this legislative language?

RESPONSE: I strongly support the adoption of the proposed legislative language. It would prohibit a creditor from collecting fees, costs, or charges if those amounts are not disclosed in a court filing and sent to the debtor and trustee in a specified period and if those amounts are not lawful, reasonable or provided for in the agreement. The proposed language has great merit because it not only deems fees, costs, or charges that do not meet those criteria to be waived but also makes any effort to collect such amounts a violation of existing bankruptcy law pursuant to either section 524 or section 362. Such an amendment will give homeowners a remedy for a creditor's wrongful collection efforts.

3. I am interested in the role that limitations in the computer systems of mortgage servicers might play in assessing unwarranted fees. I understand that most national mortgage servicers use a program called the Mortgage Servicing Platform, a.k.a. the Fidelity National Information System. In a case last year, *In re Nosek*, 363 B.R. 643 (Bkrtcy. D. Mass. 2007), Ameriquest stated the following in its opening brief on appeal: "At present, no computer program exists that is capable of accounting for payments by Chapter 13 borrowers under the bifurcation scheme that is usually used in most Chapter 13 cases." As I understand it, this "bifurcation scheme" to which Ameriquest alludes is simply the fact that once a bankruptcy plan is confirmed, all payments made to new monthly liabilities should be applied against those new liabilities rather than against older pre-bankruptcy debt, since that older debt is handled separately as part of the lender's claim.

   a. Chapter 13 has been on the books for 30 years. To the extent of your knowledge, is it accurate today that "no computer program exists that is capable of accounting for payments by Chapter 13 borrowers"?
   b. If this is accurate, do you believe this is a case of willful neglect on behalf of the servicers so that they can assess and collect more fees?

RESPONSE: In response to part (a) of the question, I am not aware of any available computer program that applies payments in Chapter 13 bankruptcy cases in the manner required by bankruptcy law, which you correctly describe as a bifurcation scheme that has existed for 30 years. During the years that I have been a law professor, there have been repeated calls for such software from trustees, judges, and debtor's attorneys. While there may be a beta or test version of such software currently in existence, to the best of my knowledge, there is no product that is commercially available or ready for widespread adoption. The testimony of employees of mortgage servicers has described how the available software applies payments in violation of the confirmed Chapter 13 plan and imposes charges and fees on bankrupt debtors' accounts that are the result of the misapplication of payments.

In response to part (b) of the question, I believe that mortgage servicing in bankruptcy cases has crossed the threshold from neglect to what can be fairly characterized as intentional misbehavior. Neglect implies a lack of awareness of a problem; this is an inapt term for the state of mortgage servicing in bankruptcy. For at least ten years, debtors' attorneys and trustees have complained about inaccurate and illegal mortgage servicing. In the last few years, the number of complaints has escalated, and court opinions have made explicit findings that the practices of mortgage servicers violate the law. Mortgage servicing is a billion-dollar industry. These are not small companies that lack the resources to develop an automated process for servicing loans in bankruptcy. Instead mortgage servicers appear to be willfully refusing to correct their illegal practices, despite repeated warnings and years of opportunity to do so. Because mortgage servicers retain default fees that borrowers pay as profit, servicers lack a financial incentive to service mortgage loans in bankruptcy in accord with the law. The law needs to be changed to create a sanction for unlawful mortgage servicing in bankruptcy. Without such a countervailing incentive, servicers will continue to assess unwarranted fees and refuse to invest in improved technology and processes.

4. It seems that the current prohibition against modifying a mortgage on a primary residence in bankruptcy may be playing a role in enabling mortgage lenders and servicers to assess inappropriate fees against debtors in bankruptcy.

For example, when the debtors in *In re Padilla,* 379 B.R. 643 (Bkrtcy. S.D. Tex. 2007) contended that the servicer had sent them a bill for new fees after they had exited bankruptcy, the creditor argued it should not have to file a fee application like other creditors because that would have been an improper modification to the mortgage.

In another case, *In re Sanchez,* 372 B.R. 289 (Bkrtcy. S.D. Tex. 2007), the mortgage servicer argued that the prohibition on modifying primary mortgages "renders the contractual language sacrosanct," and therefore that fees do not have to be disclosed for mortgages like they do for other debts.

How much of the problem of inappropriate fees would disappear if mortgages on primary residences could be modified in bankruptcy just like any other debts?

RESPONSE: The current Bankruptcy Code prohibits courts from modifying debts that are secured by a debtor's principal residence, a limitation that does not exist for other debts secured by real property. As noted in the cases cited in the above question, mortgage servicers have seized upon this anti-modification language to argue that a bankruptcy court lacks jurisdiction to rule on the legality of fees and charges that it imposes on debtors. I believe this is an incorrect and unsupported interpretation of the anti-modification provision. However, this argument—and the costs of litigating this issue—does deter trustees and debtors from objecting to questionable fees or charges. Essentially, the mortgage servicers are attempting to use the anti-modification statute as a sword to attack debtors with undisclosed or illegal fees, rather than for its intended purpose as a shield to constrain a court's ability to modify the substantive terms of a mortgage. Permitting courts to modify mortgages in bankruptcy would render such arguments patently frivolous. If this purported "defense" to undisclosed or impermissible fees were eliminated, debtors and trustees would not have to expend resources litigating this issue, and courts would be more likely to exercise their authority to impose sanctions on a creditor that attempts to collect illegal or unjustified fees.

Questions from Senator Jeff Sessions

1. In your written statement, you discuss "dozens and dozens" of questionable fees in Chapter 13 cases which were never objected to. Do you know why these fees were not objected to? Do you believe that attorneys for debtors have an obligation to object to questionable fees on behalf of clients?

RESPONSE: My study did not assess why any specific fee in any specific case was not objected to by a debtor, a debtor's attorney, the Chapter 13 trustee, or another party in interest. However, I have talked to, or had written communication, with hundreds of debtors' attorneys and trustees about this issue since my study began. Based on these interactions, I believe there are several reasons that debtors' attorneys or trustees do not routinely object to unidentified or questionable fees, costs, and charges that appear on claims.

First, the lack of documentation attached to the claims makes it hard for any party—even a court—to verify whether a fee is legitimate without engaging in substantial litigation. The purpose of the existing rules is to put the burden of disclosing the basis for the fees on the creditor. When servicers ignore the rules, they make it much harder for debtors and their attorneys to object. An objection must be grounded in fact and a good faith legal argument. If the nature of fee is unidentified, it is very difficult for debtors or attorneys to raise an objection because they cannot point to the specific reason why the fee should be disallowed. They can merely complain that they have no way to determine whether the fee is legitimate without documentation, at which point many courts dismiss the objection unless the debtor can proffer a specific reason that the amount of the claim may be incorrect. Thus, the lack of documentation or disclosure bolsters the ability of servicers to charge illegal fees because it obscures such misbehavior and shifts the responsibility onto debtors and their attorneys to investigate the claim, while simultaneously depriving them of any means to conduct such an investigation.

Second, the costs in money and time of forcing mortgage servicers to comply with the disclosure rules and identify charges with specificity are substantial. Indeed, the bankruptcy courts that have investigated the propriety of such fees have noted in written opinions that extensive resources were expended by the court and the litigants to decipher the nature and legitimacy of the fees. The mortgage servicers' failure to document their charges ratchets up the costs on debtors and attorneys of objecting to fees. Because these fees are often relatively small in absolute dollars (between a few hundred and a few thousands of dollars in many instances), the costs of such fact-intensive litigation can quickly surpass the amount at issue. This problem is worsened because courts sometimes do not award attorneys fees to debtors' attorneys, even if such attorneys show that the mortgage servicer attempted to overcharge the consumer or violated the rules of legal practice. Other courts limit the amount of such attorneys fees to the amount in controversy, leaving the debtor or their attorney to suffer a financial loss for their efforts to police compliance with mandatory bankruptcy rules.

I do believe that attorneys for debtors have a duty to review mortgage claims and to object to those without documentation or those with unsubstantiated or questionable fees. I also believe that Chapter 13 trustees have a duty to review and object to claims. Amending section 502(b) of the Bankruptcy Code to permit a court to disallow a claim that a creditor refused to substantiate with documentation after objection and an opportunity to do so would give debtors' attorneys and trustees a clear legal basis for raising objections to undocumented or questionable fees.

2. In your written statement, you stated that "[a] majority of claims (52.77%) lacked one or more required attachments." Could you provide information on how many of these claims lacked one piece of required documentation, how many lacked two pieces of required documentation and how many lacked three or more pieces of required documentation.

RESPONSE: I am pleased to provide you with these findings, which reflect data from a sample of over 1700 Chapter 13 bankruptcy cases. The study is described in more detail in my paper, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*.[1] That study examined 1768 proofs of claim filed with respect to mortgage loans on debtors' principal residences.[2] I examined each of these claims for the presence of three pieces of documentation: a copy of a promissory note or document establishing the debt, a copy of a mortgage granting the creditor a security interest in the debtor's home, and an itemization of interest or other charges.[3] One required document was missing from nearly one-third (32.8%) of claims (n=579). Two required documents were missing from 15.7% of the claims (n=277). All three required documents were missing from 4.2% of the claims (n=75). In total, more than half of all claims were missing at least one piece of documentation. Analysis showed that the most commonly missing document was the mortgage note, which usually specifies when fees may be assessed and any limits on the amount of fees, such as late charges.

3. Please identify and discuss cases (published or unpublished) where courts have been asked to disallow a mortgage claim because the claim was not accompanied by proper documentation, but where the court allowed the claim anyway.

RESPONSE: Under the existing bankruptcy law, most courts allow claims even if they are not accompanied by required documentation. For example, in In re Long, a Chapter 13 debtor objected to a mortgage claim filed by Matrix Financial Services to which there was neither a promissory note nor a perfected security interest attached.[4] The court allowed the claim, however, because Matrix provided such documentation upon the debtor's objection. This outcome puts the burden on the debtor to make an affirmative request for documentation that is required by the rules.

The most troubling aspect of the current case law is that a majority of courts does not require a creditor to produce documentation, *even upon a debtor's objection*, in order to allow the creditor's claim. These courts conclude that because failure to attach documentation is not a specifically listed basis for disallowing a claim in section 502(b) of the Bankruptcy Code, a

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[1] Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEXAS L. REV. ___ (forthcoming 2008), available at http://ssrn.com/abstract=1027961.

[2] Some servicers did not file a claim, usually because the debtor was not delinquent on the mortgage note at the time of the bankruptcy. In other instances, a debtor had more than one home loan and thus more than one mortgage claim was filed in a particular case. Thus, the number of claims (n=1768) is different than the number of bankruptcy cases (n=1733).

[3] These documents are required, respectively, by Rule 3001(c), Rule 3001(d), and the official proof of claim form (Form 10).

[4] *In re* Long, 353 B.R. 1, 13 (Bankr. D. Mass. 2006).

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court may *not* disallow a claim on that ground unless the debtor alleges a specific factual or legal basis for contesting the debt.[5] Yet, without any documentation, the debtor may not be able to discern the factual or legal basis for the creditor's claim and will not know the amount or purported basis of any assessed fees or charges that are included in the claim. The creditor's failure to provide documentation effectively handicaps a debtor from being able to allege a factual or legal dispute with any specificity.

Most cases have arisen in the context of claims for unsecured debt, rather than mortgage claims. However, such cases are precedent for how courts would adjudicate objections to mortgage claim because the documentation requirements apply to all claims. To date, to the best of my knowledge, every appellate court to consider the issue thus far has determined that a lack of documentation is not a permissible ground for disallowing a claim. The Bankruptcy Appellate Panel of the 10th Circuit recently concluded that "the language of the statute [section 502] is clear and unambiguous in establishing an exclusive list of grounds for disallowance. It does not include a failure to conform with [Rule 3001's] requirements."[6] The court in In re Heath noted that "[n]oncompliance with Rule 3001(c) is not one of the statutory grounds for disallowance" under section 502(b) and concluded that failure to attach documentation was not itself a basis to disallow the claim.[7] In another case, an appellate court concluded that it was sufficient that the creditor had complied with the "spirit" of the documentation rule.[8] The court said that the debtor's objection failed because the debtor "never presented any evidence to contradict the claims, much less any evidence that the claims fall within one of the exceptions set forth in Section 502(b)."[9] As one judge explained, the majority position deems a claim to be creditor "even if the claimant can offer no factual basis in its support."[10]

The effect of these rulings is to require a debtor to allege specific facts to make an objection that is sufficient to disallow a claim. Yet, such an objection is virtually impossible if the creditor is uncooperative. For example, if a mortgage servicer refuses to provide a complete and comprehensible payment history, the debtor, trustee, or other parties cannot assess how the creditor calculated the purported amount of its claim. The purpose of the rules is thwarted if the creditor—the party in control of the records and who is the only entity that knows the basis of the alleged charges that it has imposed—can obfuscate any scrutiny of its claim by failing to provide documentation. Without any information regarding the claim, the debtor or trustee cannot evaluate the legality of the claim or identify with specificity the reason the claim should be disallowed.

Given the existing case law, I believe that an amendment to section 502(b) is absolutely necessary to clarify that a claim should be disallowed if a creditor cannot and does not, upon

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[5] *In re* Campbell, 336 B.R. 430, 434 (B.A.P. 9th Cir. 2005) (holding that a proof of claim that lacks documentation required by Rule 3001(c) is not disallowed unless the debtor's claim objection contests the amount of the debt and not merely the rule violation).
[6] *In re* Kirkland, 379 B.R. 341, 347 (10th Cir. B.A.P. 2007).
[7] *In re* Heath, 331 B.R. 424 (9th Cir. B.A.P. 2005); *see also* Alane A. Becket, *Proofs of Claims: A Look at the Forest* 23-JAN AM. BANKR. INST. L. REV. 10 (Dec./Jan. 2005) (concluding that disallowance on Rule 3001 grounds is not within a court's statutory authority because bankruptcy rules are not supposed to abridge, enlarge or modify substantive rights under 28 U.S.C. § 2075.)
[8] *In re* Dove-Nation, 318 B.R. 147, 152 (8th Cir. B.A.P. 2004)
[9] *Id.*
[10] *In re* Kirkland, 379 B.R. 341, 359 (10th Cir. B.A.P. 2007) (J. Michael, dissenting).

objection, prove the validity of its claim. As the party requesting payment, creditors should be required to produce evidence to support the existence and amount of their purported debts. Under nonbankruptcy law, if a creditor were to file a collection or foreclosure lawsuit, it would be required to make specific factual allegations in its complaint to support the entry of a judgment. Creditors should not be held to a lesser standard in bankruptcy. If the debtor, trustee or other party in interest objects to a claim because it lacks documentation and factual support, the creditor should be required to prove its claim before it is paid from the bankruptcy estate at the expense of other creditors.

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

September 5, 2008

The Honorable Charles E. Schumer
Chairman
Subcommittee on Administrative Oversight and the Courts
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Please find enclosed a response to questions arising from the appearance of Executive Office for United States Trustees Director Clifford J. White, III, before the Committee on May 6, 2008, at a hearing entitled "Policing Lenders and Protecting Homeowners: Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?".

We hope that this information is of assistance to the Committee. Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

Keith B. Nelson
Principal Deputy Assistant Attorney General

Cc: The Honorable Jeff Sessions
Ranking Member

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

May 6, 2008

Questions for the Hearing Record
for

Clifford J. White, III
Director
Executive Office for United States Trustees
United States Department of Justice

QUESTIONS FROM SENATOR SCHUMER:

1. **It is my understanding that in order to operate at the FY 2008 enacted level, the USTP has had to take several actions, including but not limited to:**

   - **An immediate hiring freeze with limited exceptions;**
   - **Reductions in automation and information technology support, planned studies and evaluations, training, equipment replacements, and other categories.**

   a. **Is a hiring freeze still in place at the USTP Program?**

RESPONSE:

Yes, the hiring freeze remains in place. In developing the FY 2008 operating budget, it was necessary for the U.S. Trustee Program (USTP or Program) to impose a hiring freeze with limited exceptions in order to achieve an on-board FTE level of 1,275 by the end of the fiscal year. The Program plans to reduce its on-board staffing by 20 positions and is unable to fill approximately 100 vacancies. This action was necessary to stay within the constraints of the appropriation in the FY 2008 Consolidated Appropriations Act, a reduction of $22.1 million below the FY 2008 current services level and $13.4 million below the FY 2007 appropriation.

   b. **If so, how long do you anticipate it will remain in place?**

RESPONSE:

The USTP anticipates the hiring freeze will remain in place through the end of the fiscal year.

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c. To what extent is the hiring freeze hampering the U.S. Trustees' efforts around the country?

RESPONSE:

In order to operate at a reduced level, the Program has streamlined and re-prioritized its work to satisfy its statutory obligations. Assuming bankruptcy filings for FY 2008 remain in the 950,000 to 975,000 projected range, the Program believes it will be able to perform its core duties at the FY 2008 appropriations level.

2. Likewise, can you please elaborate on the other reduction and cuts that are going on at the U.S. Trustee Program now?

a. For instance, what training programs have been cut, and when do you plan on re-implementing them?

RESPONSE:

The USTP conducts educational programs at its National Bankruptcy Training Institute (NBTI), which is part of the National Advocacy Center in Columbia, SC. On average about 13 courses are presented at the NBTI each fiscal year. In order to operate within the FY 2008 funding constraints, the USTP had to reduce the number of courses it will offer this fiscal year to eight. Programs eliminated in FY 2008 included a chapter 11 course for attorneys, training for chapter 7 private trustees, a managers' conference for United States Trustees and Assistant U.S. Trustees, and a meeting of bankruptcy fraud working groups. In addition, a standalone creditor abuse training course has been delayed until early next fiscal year, although creditor abuse continues to be included as an element in training courses presented by the Program.

With the FY 2009 budget request being a current services request, the USTP anticipates that it will need to again restrict training at the NBTI to approximately eight courses next fiscal year. As a result, the USTP will pursue alternative means to offer critical training to staff, including: (1) enhanced use of video on demand available through the U.S. Attorney's Learning Management Center, which allows employees to access online programs via their desktop computer; (2) production of a video training program on creditor abuse issues; and (3) brown bag conference calls and video teleconferences on topics of immediate importance or use to staff.

b. Also, what kinds of automation and information technology support have been restricted or cut?

RESPONSE:

The Program has had to significantly restructure its information technology (IT) resources to be able to continue to meet its top priorities. This necessarily has required delaying or canceling a number of infrastructure projects and other initiatives, including enhancements to existing systems, contingency site and centralized data storage efforts, and migration off a legacy case management system. Fortunately, the significant IT advancements that the Program has made since passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, such as improvements to existing systems that help manage caseloads and measure Program activity, and the development of a number of systems designed to meet new statutory mandates, have enabled the USTP to absorb this reduction in IT resources without an immediate adverse impact on office operations. The USTP will continue to work to minimize the potential long-term affects of these changes to its IT program, and to explore opportunities to maximize the productivity of available systems.

c. **And so I'll ask a similar question to the one I asked before – are these cuts getting in the way of the U.S. Trustee Offices doing their job?**

RESPONSE:

As indicated above, the reduction in FY 2008 appropriations required the USTP to streamline and re-prioritize its work. As a result, the Program has been able to perform its core duties at the FY 2008 appropriations level.

3. **Is the U.S. Trustee Program adequately staffed?**

RESPONSE:

Assuming that bankruptcy filings remain in the 950,000 to 975,000 projected range during FY 2008, the USTP believes that it has sufficient staff to carry out its core duties. The FY 2009 budget requests an appropriation of $217.4 million for the USTP. The budget request estimates that the appropriation will be offset by $167.7 million in fee collections during FY 2009 and that $49.7 million of the total will be derived from prior year balances in the U.S. Trustee System Fund. The USTP anticipates that filings will continue to increase gradually during FY 2009. With the staffing and spending cuts implemented in FY 2008, an appropriation of $217.4 million will permit the Program to address its projected FY 2009 workload. Should filings exceed projections, the USTP would work through the Department and the Office of Management and Budget to address the increased workload.

4. **Do you believe that the U.S. Trustee Program is adequately funded? Are there areas in which the U.S. Trustee Program is inadequately funded?**

RESPONSE:

If bankruptcy filings remain at the current projected level, the USTP will meet its statutory obligations at the level included in the President's budget request for the Program.

QUESTIONS FROM SENATOR DURBIN:

1. **In order to address the challenge of mortgage companies imposing unreasonable and inappropriate fees in bankruptcy, it appears a clean and sensible approach would be to require that debtors and trustees be given adequate notice of all fees imposed upon debtors in bankruptcy.**

Do you agree with this approach?

RESPONSE:

The integrity and efficiency of the bankruptcy system are better achieved if debtors and trustees are given adequate notice of all fees imposed on debtors. The purpose of chapter 13 itself is defeated if a debtor completes a five year repayment plan and, after the case is closed, faces foreclosure or other collection attempts because of fees and charges the debtor never had adequate notice of or an opportunity to cure while in bankruptcy.

2. **I have introduced S.2136, the Helping Families Save Their Homes in Bankruptcy Act, which has been reported out of the Senate Judiciary Committee. S.2136 as reported would require adequate notice of bankruptcy fees imposed by mortgage companies, and would allow a bankruptcy judge to waive prepayment penalties on home mortgages. It would do so by amending 11 U.S.C. 1322(c) so that it would read as follows (with new paragraphs in italics):**

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law–
(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law;
(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title;
(3) the plan need not provide for the payment of, and the debtor, the debtor's property, and property of the estate shall not be liable for, any fee, cost, or charge, notwithstanding section 506(b), that arises in connection with a claim secured by the debtor's principal residence if the event that gives rise to such fee, cost, or charge occurs while the case is pending but before the discharge order, except to the extent that–

> ***(A) notice of such fees, costs or charges is filed with the court, and served on the debtor and the trustee, before the expiration of the earlier of***
>
> > ***(i) 1 year after the event that gives rise to such fee, cost, or charge occurs; or***
> >
> > ***(ii) 60 days before the closing of the case; and***
>
> ***(B) such fees, costs, or charges are lawful, reasonable, and provided for in the agreement under which such claim or security interest arose;***

(4) the failure of a party to give notice described in paragraph (3) shall be deemed a waiver of any claim for fees, costs, or charges described in paragraph (3) for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a

violation of section 524(a)(2) of this title or, if the violation occurs before the date of discharge, of section 362(a) of this title; and
(5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the principal residence of the debtor.

What are your views on this legislative language?

RESPONSE:

This proposed amendment to section 1322(c) conditions liability for fees, costs, or charges incurred while the chapter 13 bankruptcy case was pending on the mortgage holder serving upon the debtor and the trustee, and filing with the court, notice of such fees, costs, or charges. Currently, courts are divided over whether such fees, costs, or charges must be approved by the court. As drafted, the proposed amendment also provides that fees, charges, and costs must be lawful, reasonable, and provided for in the loan contract; however, it does not provide that the court may disallow fees, costs, or charges, or establish a procedure by which the court could determine these issues. It should also be noted that the requirement that the notice be filed 60 days before the closing of the case could be problematic since it is generally not possible to know with certainty when a bankruptcy case will actually close. Furthermore, this requirement would effectively prevent mortgage lenders from ever collecting any fees, costs, or charges incurred by debtors in the 60 days before the closing of their cases.

3. **I am interested in the role that limitations in the computer systems of mortgage servicers might play in assessing unwarranted fees. I understand that most national mortgage servicers use a program called the Mortgage Servicing Platform, a.k.a. the Fidelity National Information System. In a case last year, *In re Nosek*, 363 B.R. 643, (Bkrtcy. D. Mass. 2007), Ameriquest stated the following in its opening brief on appeal: "At present, no computer program exists that is capable of accounting for payments by Chapter 13 borrowers under the bifurcation scheme that is usually used in most Chapter 13 cases." As I understand it, this "bifurcation scheme" to which Ameriquest alludes is simply the fact that once a bankruptcy plan is confirmed, all payments made to new monthly liabilities should be applied against those new liabilities rather than against older pre-bankruptcy debt, since that older debt is handled separately as part of the lender's claim.**

   a. **Chapter 13 has been on the books for 30 years. To the extent of your knowledge, is it accurate today that "no computer program exists that is capable of accounting for payments by Chapter 13 borrowers"?**
   b. **If this is accurate, do you believe this is a case of willful neglect on behalf of servicers so that they can assess and collect more fees?**

RESPONSE:

The USTP cannot verify the accuracy of the statement that "no computer program exists that is capable of accounting for payments by Chapter 13 borrowers." Therefore, it is not

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currently in a position to comment on whether there is willful neglect on the part of mortgage servicers.

4. **In your written testimony you say that the U.S. Trustee Program has more than 30 cases involving mortgage servicer violations currently under review. Your testimony also stated that there has been "an increasing number of complaints about the accuracy of bankruptcy court filings made by some mortgage servicers."**

 a. **Approximately how many complaints of this type have you received?**

RESPONSE:

The USTP does not maintain a log of complaints it receives on mortgage servicer issues. Some of the complaints received are general and are not followed by more specific information from the complainant. Although anecdotal, the volume of specific and general complaints, particularly those raised by the judiciary, has risen in recent months.

 b. **What percentage of complaints does the U.S. Trustee follow up on with a further review?**

RESPONSE:

Program policy provides that credible complaints about mortgage servicer practices should be referred to the Executive Office for United States Trustees (EOUST). The Director designated a national working group to review complaints and devise a coordinated approach for addressing the problem. Litigation is centrally directed by the EOUST utilizing attorneys from both the field and headquarters. Complaints received by the EOUST are reviewed and action taken as appropriate.

 c. **Are resource limitations preventing the U.S. Trustee from intervening in more cases involving servicer misconduct?**

RESPONSE:

The Program's investigation of and litigation with mortgage servicers has been resource intensive. Reductions in appropriations in FY 2008 required the Program to re-prioritize its work in order to ensure minimally adequate staffing to address mortgage servicer issues and other critical projects.

5. **Professor Porter recommended in her testimony that in order to curb abuses by mortgage servicers, the U.S. Trustee Program should mandate the review of mortgage claims as an official duty of trustees. She also recommended that if a Chapter 13 trustee finds serious or systemic misconduct during this mandated review, the problem should be referred to the U.S. Trustee for enforcement action.**

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What are your views on this proposal?

RESPONSE:

With regard to the review of mortgage claims, the USTP requires chapter 13 trustees to review all proofs of claim filed by creditors. Specifically, the *Handbook for Standing Chapter 13 Trustees* instructs that "it is always incumbent upon a standing trustee to review proofs of claim . . . [to] ensure that such claims are proper with respect to timeliness of filing, dollar amount and supporting documentation." Handbook at pages 6-10 (eff. 12/1/98). However, the Program's increased scrutiny of mortgage servicer practices indicates that the degree of review of proofs of claim by chapter 13 trustees may vary from district to district. The Director will review current USTP policy to determine if a change is appropriate to strengthen the current requirement.

As to serious or systematic misconduct by parties in a bankruptcy case, chapter 13 trustees have been directed to refer such matters to their United States Trustee. Though most instances of over-reaching by creditors are appropriately handled by trustees and debtors' attorneys as traditional claims objections, where the integrity of the bankruptcy system is at risk, action by the United States Trustees is appropriate. The USTP has engaged in a major outreach effort both to trustees and to the bankruptcy community to make clear that the Program will investigate referrals and take appropriate action against mortgage servicers who systematically violate their obligations under the Bankruptcy Code and Rules. This outreach has been carried out through speeches before national and local bankruptcy organizations, published articles, and training programs for trustees and the bar.

6. **In her testimony Ms. Miller said that Chapter 13 trustees are often unable to communicate with or even locate servicers during the pendency of a bankruptcy.**

   Do you agree with Ms. Miller that there should be a requirement that mortgage servicers make available a dedicated phone line and contact for Chapter 13 trustee use?

RESPONSE:

The USTP wholeheartedly supports efforts to enhance communications between chapter 13 trustees and mortgage servicers, and would encourage servicers to consider implementing this provision from the National Association of Chapter 13 Trustees' "Best Practices for Trustees and Mortgage Servicers in Chapter 13." The USTP does not, however, have the authority to mandate such a practice by private companies.

QUESTIONS FROM SENATOR SESSIONS:

1. **At the hearing, some claimed there is ambiguity under current law regarding whether attorneys may be sanctioned for filing erroneous proofs of claim. You testified there are instances when sanctions can be imposed for filing inaccurate proofs of claim.**

   a. **Please identify examples of when it is appropriate, under current law, for sanctions to be levied against a creditor's attorney for filing an inaccurate proof of claim.**

RESPONSE:

Attorneys are specifically subject to monetary sanctions under Bankruptcy Rule 9011, which provides that an attorney who presents to the court by signing, filing, submitting, or later advocating a petition, pleading, written motion, or other paper is certifying to the best of his "knowledge, information, and belief, formed after an inquiry reasonable under the circumstances" that, among other things, "factual contentions have evidentiary support." For example, in the recent case of *In re Nosek*, 2008 WL 1899845 (April 25, 2008, Bankr. D. Mass.), the court sanctioned a mortgage servicer's national counsel $100,000 for misrepresentations associated with the production and filing of inaccurate proofs of claim it filed on behalf of its clients. While the *Nosek* case was at the court's initiative, Rule 9011(c) does present some procedural hurdles when sanctions are sought by another party, including a provision which may permit attorneys to avoid sanctions by simply withdrawing or correcting the offending document when it is challenged as erroneous.

In addition, section 152(4) of title 18 provides that an attorney could be found criminally responsible for knowingly and fraudulently filing a false proof of claim in a bankruptcy case and be subject to a fine up to $500,000 or imprisonment for up to five years, or both.

   b. **Are these standards uniform in application or are they subject to interpretation within various districts, thereby creating a patchwork of enforcement?**

RESPONSE:

Legal disputes have arisen regarding sanctions for filing inaccurate proofs of claim. Apart from factual disputes, and separate from Rule 9011 and 18 U.S.C. § 152(4) discussed above, issues have arisen regarding the scope of the court's inherent authority to impose sanctions, including the burden of proof. *In re Parsley*, ___ B.R. ___, 2008 WL 622859 (Bankr. S.D. Tex. Mar. 5, 2008)

Insofar as the United States Trustee is engaged in litigation that involves or may involve questions as to the availability of sanctions to impose against parties who file inaccurate proofs of claim, it would be inappropriate at this time to provide additional analysis of case and statutory law.

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2. **The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 strengthened attorney sanctions, for both debtor and creditor attorneys, when filing an erroneous "petition, pleading, or written motion." There exists ambiguity whether this language covers a proof of claim or an objection to a proof of claim. Please explain your interpretation of this provision and whether you believe a proof of claim falls within current law.**

RESPONSE:

The statutory provision quoted in this question does not support an award of sanctions against a mortgage creditor's attorney for the filing of an inaccurate proof of claim in a chapter 13 case. The language is found in section 707(b)(4)(C), a provision in chapter 7 of the Bankruptcy Code. By operation of 11 U.S.C. § 103(b), section 707(b)(4)(C) applies only to cases filed under chapter 7.

3. **While there is a bankruptcy rule requiring the documents and information to be attached to a proof of claim, some stakeholders have informed us there may be varying and differing local rules and practices regarding what documents are to be supplied when proofs of claim are filed.**

   a. **What steps do you think are required to ensure the required documents are included when filing a proof of claim as required for under current law?**

RESPONSE:

Federal Rule of Bankruptcy Procedure 3001(c)-(d) and Official Form 10 require creditors generally to attach to the proof of claim written evidence of a debt and perfection of any security interest. There are varying local rules and practices regarding documentation, though the USTP is not aware of any rules that abrogate the evidence of debt and security interest requirements. It is incumbent upon a trustee or a debtor's attorney to object to a proof of claim if its lack of documentation prevents a determination as to the validity of the claim or of any lien securing it. The Judicial Conference has the authority to propose amendments to the bankruptcy rules and official forms.

4. **Do you believe that the USTP needs additional statutory authority to examine the business practices of mortgage servicers with customers in Chapter 13?**

RESPONSE:

The USTP believes it has sufficient statutory authority to examine the business practices of mortgage servicers with customers in chapter 13. USTP authority was recently upheld in *In re Countrywide Homes Loans, Inc.*, ___ B.R. ___, 2008 WL 868041 (Bankr. W.D. Pa. Apr. 1, 2008), which is currently on appeal to the United States District Court for the Western District of Pennsylvania.

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5. **Some have argued that failure to file all documentation and paperwork should constitute a basis for disallowing a claim. In the mortgage context, because real property liens flow through bankruptcy, what would the ultimate effect be on homeowners?**

RESPONSE:

The current requirement that a creditor adequately document its proof of claim arises under Bankruptcy Rule 3001(c)-(d). Courts are in general agreement that a creditor's failure to comply with this Rule is not an independent basis for the disallowance of a claim. If section 502(b) of the Bankruptcy Code were amended to provide that the failure of a creditor to adequately document its proof of claim was a basis for disallowing that claim, any lien securing the disallowed claim may arguably be void by operation of section 506(d) unless that section were itself amended. It should be noted that an amendment to section 502(b) without clarification of section 506(d) would likely result in litigation.

SUBMISSIONS FOR THE RECORD

Senate Judiciary Subcommittee on Administrative Oversight and the Courts

"Policing Lenders and Protecting Homeowners:

Is Misconduct in Bankruptcy Fueling the Foreclosure Crisis?"

May 6, 2008

TESTIMONY OF ROBIN ATCHLEY

Good afternoon.

My name is Robin Atchley. I am honored to testify before the subcommittee about my family's struggle to save our house from foreclosure in the bankruptcy court. My husband, John, and my children, Kally, Payden, Alec and Morgan, are here with me today. Our lawyer, Howard D. Rothbloom, is sitting next to me.

I work as a letter carrier for the United States Postal Service. John works as a lineman for the power company.

In 2004, our family moved from a single-wide mobile home into our own brand new house that we bought in Waleska, Georgia. We put down $22,000 on the house and we financed the rest.

One year later, our mortgage was refinanced by American Freedom Mortgage to put up a fence and to finish the basement so that our children would each have their own bedrooms. We did most of the work ourselves.

We were notified to make payments to a company called "Countrywide".

For some time, we were able to keep up with our payments to Countrywide. But when my sister passed away unexpectedly, I needed time to grieve. So, I took unplanned and unpaid leave from my job.

Then, we struggled to pay our bills. We didn't have much debt. But we did fall behind on our mortgage payments.

Our lawyer explained to us that in Georgia, a mortgage company can foreclose in just over a month without going to court. So, in October 2005, we sought refuge in the bankruptcy court. We had hoped that bankruptcy would allow us to pay our debts and to keep our house.

When we filed for bankruptcy, we were about $5,000, or three mortgage payments, behind. The $5,000 was to be paid in monthly installments through the bankruptcy court, and the current due mortgage payments were paid monthly directly by us.

Our bankruptcy case was a tug of war with Countrywide over our house. Sometimes, our mortgage payments were late. But Countrywide, through its lawyers, McCalla Raymer, was too quick to "pull the trigger". Legal papers became weapons. In February and in May 2006, Countrywide filed motions for relief from the automatic stay asking the bankruptcy judge for permission to foreclose on our house when we were current on our mortgage payments. Both times, not until our lawyer gave McCalla Raymer proof that the payments had been made, did Countrywide *withdraw* its motions. It was unforgiving. It seemed that we had no room for error. And each time that it sought permission to foreclose, there was confusion: no person with Countrywide or McCalla Raymer could ever give us clear information on what they claimed that we owed and why we owed it. It was as if all they wanted was to take our house.

We had hoped that bankruptcy would give us a fair chance to save our house. But that was a false hope. It seems as if Countrywide used the bankruptcy court to gain even more opportunities to take advantage of our predicament and to profit from our struggle.

Nonetheless, with our lawyer's help, we won the battles.

Eventually, however, John and I just tired of the war. And it took a toll on our whole family. Our son, Payden, even insisted that we use his lunch money to help pay the mortgage payments.

We did the best that we could. Our lawyer did the best that he could. Together, we did the best that anyone could.

Our house was our family's first house... it was our dream home. John and I had hoped to raise our children there and live there for the rest of our lives. But, regretfully, John and I decided that it would be best to sell it. The monthly bankruptcy payments, the monthly mortgage payments, and the whole bankruptcy process were drowning us. We knew that selling the house would enable us to get our heads above water.

In May 2007, Countrywide sent a Payoff Demand Statement showing that the total amount owed on our loan was $199,004.80. The proof of claim Countrywide filed in our case in December 2005, however, showed that we owed $184,896.72: $14,108.08 less than the payoff amount demanded by Countrywide... and that is without giving us credit for post-petition mortgage and bankruptcy court payments sent to Countrywide. Yes, we were behind on

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payments on the day that we sold the house, but we don't know why the payoff amount was so high.

Also, on the payoff statement, there was a $2,793.00 charge for "fees due". We don't know what the fees were for or why they were so high. In the proof of claim, Countrywide said that we owed just $242.50 in fees: $2,550.50 less than the fees listed in the payoff statement.

We sold the house in the middle of May and paid the amount that Countrywide said that we owed. In fact, we had to pay money out of our pockets at the sale to get out of the house... that just didn't seem right. And, according to our lawyer, Countrywide continued to take money from us through the bankruptcy court even after it was paid in full from the sale. That didn't seem right either. They didn't stop until after our lawyer objected.

The saddest day was the day that we told our children to pack everything in their bedrooms. With suitcases in hand, my husband, our four children and I stuffed the car with our belongings and moved in with my parents until we could save enough money to rent.

We are not bad people. We work hard. We try to follow the rules. John and I are trying to raise our children to be good and decent. We are probably just a typical American family.

Our house is gone. There is nothing that anyone can do to change that.

Now our home is a house that we rent from someone else.

And our son doesn't have to worry about his lunch money anymore.

We hope our story will help others. Thank you.

Couple lose home, but may yet win: Feds seek sanctions, say Countrywide abused bankruptcy laws
CARRIE TEEGARDIN. **The Atlanta Journal - Constitution.** Atlanta, Ga.: Mar 30, 2008. pg. E.1

Robin Atchley remembers one moment in her family's ordeal with Countrywide Home Loans as the absolute low point: the afternoon she told her four children to start packing up everything in their bedrooms.

It was time to leave home.

Robin Atchley and her husband, John, had spent the previous six months working furiously to avoid such a scene. Their plan had been to watch the kids grow up in their five-bedroom house in a rural corner of Cherokee County.

Unlike many families caught up in the mortgage meltdown, the Atchleys did not lose their house because they couldn't make their mortgage payments.

They lost it because of the expense and frustration of trying to force Countrywide to comply with bankruptcy laws that are supposed to offer a safe harbor to committed homeowners.

The massive California-based lender and its Atlanta law firm, McCalla Raymer, went to bankruptcy court twice within three months seeking permission to foreclose, claiming the Atchleys had not paid the mortgage. But the Atchleys' lawyer produced receipts in both cases proving that the Atchleys had indeed made their payments.

The problems didn't end there. The family says that Countrywide repeatedly billed them for inappropriate fees and charges that pushed the cost of the mortgage beyond their reach. About the time their children hesitated to ask for lunch money, Robin and John Atchley decided enough was enough.

They sold the house and paid Countrywide a balance that they thought was well above what they really owed. Their children got in the car with their suitcases and the family moved in with Robin's parents until they could save enough money to rent a house nearby.

"We would still be in that home if it hadn't been for Countrywide," said Robin Atchley, who works as a letter carrier for the U.S. Postal Service. "They just wouldn't leave us alone."

The Atchleys moved on months ago. But someone with considerable resources decided recently to take up the fight.

The Justice Department's United States Trustee in Atlanta attracted national attention in late February by going to court asking for sanctions against Countrywide for its actions in the Atchley case.

A crackdown on lenders

The U.S. Trustee's office is charged with ensuring the integrity of the bankruptcy system. But the action in the Atchley case is an unusual one that appears to be part of a coordinated effort to crack down on lenders who may be abusing the system.

The Trustee's office won't comment on its motives, but in its filing said Countrywide engaged in "bad faith conduct that abused the judicial process."

The Trustee's effort may be inspired by an Iowa law professor's groundbreaking study that found that lenders routinely ignore the requirements of bankruptcy law when seeking repayment by consumers.

Howard Rothbloom, the Atchleys' attorney, said the scrutiny will raise the curtain on a bankruptcy system that has tolerated too many injustices for families who are working hard to hold onto their homes.

"The regular course of conduct for these lenders is to do it wrong," Rothbloom said. "The system can't work that way."

Great start, then tragedy

Robin and her husband, John, a utility lineman, put $22,000 down in 2004 when they moved out of their single-wide mobile home and bought the brand-new house in Waleska, about 50 miles from downtown Atlanta.

The next year, they refinanced with American Freedom Mortgage to pull out enough money to put up a fence and finish the basement. The project allowed their two daughters and two sons --- today ages 14, 12, 11 and 5 --- to each have their own rooms.

When the first payment book arrived, it had Countrywide's logo on the front.

The family kept up with its payments until a personal tragedy hit. Robin's sister died unexpectedly, prompting Robin to take a few weeks of unplanned leave from her job. They got behind with their bills.

To buy time to catch up, the Atchleys filed for bankruptcy in October 2005 under a Chapter 13 reorganization plan. A Chapter 13 is set up to stop repossessions and foreclosures, and establish a court-supervised repayment plan. Under such a plan, families must pay their current mortgage payments plus an extra payment that is distributed by the court to creditors.

The family had no significant debt other than their mortgage and auto loans. When their bankruptcy plan was filed, they were three months behind on the mortgage, which amounted to about $5,000. The Atchleys immediately started making payments after their plan was filed.

In February and then again in May of 2006, Countrywide's attorney, McCalla Raymer, came to court seeking permission to foreclose, saying the family had not been making its required payments.

But payment receipts proved Countrywide's action was improper.

Fighting off the foreclosure actions, however, didn't solve all the problems. Countrywide planned to up the family's monthly payment to cover "escrow" charges, even though the family covered its own homeowners insurance policy and property tax payments.

"I made four payments in two months, and they were still telling me I owed them an outrageous amount of money on late payments and stuff," Robin Atchley said.

Legal battle too costly

The Atchleys couldn't keep up. Their budget was so tight, their sons offered to pay for gas using money they had earned doing odd jobs working for relatives.

They decided they didn't have the resources for a lengthy fight against Countrywide. They also didn't have the money to pay a mortgage balance that continued to climb.

They decided to throw in the towel.

When they entered bankruptcy, Countrywide said the Atchleys owed just under $185,000. When it came time to pay off the loan, Countrywide said their pay-off total would be $199,000. The Atchleys still do not understand how Countrywide came up with such a high mortgage balance, given their payment history. The sale price of the house was about $2,000 short of what the family needed to pay commissions and Countrywide.

"We had to pay to get out of the home after we had put everything we had in it," Robin said.

The U.S. Trustee is now questioning whether the Atchleys paid Countrywide too much. Neither Countrywide nor McCalla Raymer would comment on the Atchley case, citing pending litigation.

In its court filing, the U.S. Trustee's office said Countrywide charged the family $2,793 for "fees due" --- much more than the $242 enumerated for fees in Countrywide's court filings.

Exhibits in the case show that Countrywide also charged them $2,564 for "escrow" charges, even though the family did not use escrow for taxes and insurance.

The U.S. Trustee's filing shows that Countrywide waited months to alert the bankruptcy court that the family had satisfied its debt. In the meantime, it continued to accept payments from the court made on the Atchleys' behalf.

"I still don't know if we got everything back that we should have," Robin Atchley said.

Situation not unique

The Atchleys' experience with their mortgage lender may not be unique.

Katherine M. Porter, a University of Iowa law professor, examined 1,700 recent Chapter 13 bankruptcy cases filed in 24 states, including Georgia. She discovered that mortgage lenders regularly fail to file documents required by law and that fees and charges billed to homeowners often are unreasonable.

"Bankruptcy is held out as this 'Come here, if you want to save your house,' " Porter said. "If that's what Congress wants it to be, then it needs to make sure that's how it's functioning."

Courts vs. Countrywide

The Atchleys' attorney said mortgage lenders profit by adding inappropriate fees to bankrupt borrowers' loans and often get away with it. "You have the perfect storm," Rothbloom said. "You have borrowers who are in financial disarray. They lack financial sophistication. And you have lenders who are ready, willing and able to take advantage of those circumstances."

Filings in courts across the country describe serious missteps by Countrywide and its attorneys.

A Texas judge, Jeff Bohm, rebuked Countrywide, Atlanta-based McCalla Raymer and a Texas law firm in a 72-page ruling. He found fault with each of the three parties' handling of a case in which Countrywide sought permission to foreclose on a homeowner who was up to date on payments. The Texas law firm hired by McCalla Raymer was singled out by the judge.

"Above all else, what kind of culture condones its lawyers lying to the court and then retreating to the office hoping that the Court will forget about the whole matter?" Bohm wrote.

In the wake of the ruling, McCalla Raymer managing partner John G. Aldridge said, "We are certainly paying very strict attention to the documents and evidence we present to any court."

In Ohio and Florida, the U.S. Trustee's office has filed complaints in the past month seeking sanctions against Countrywide. In Ohio, Countrywide sought payments in bankruptcy court from a homeowner who had already paid off Countrywide. In Florida, Countrywide tried three times to foreclose on a homeowner who no longer owed Countrywide any money on the property.

Countrywide has already been sanctioned in other cases.

A judge in Pennsylvania sanctioned the lender for trying to foreclose on a couple in that state who had made required payments "like clockwork," according to the judge.

Countrywide's Texas law firm was hit with a $75,000 sanction for its behavior in a case that included court filings that were "erroneous" and "clearly legal nonsense."

A judge in North Carolina sanctioned Countrywide for twice changing the locks on a house that it had sought to repossess, even though the foreclosure had been stopped by a bankruptcy filing. Countrywide's agents disposed of the family's Christmas ornaments, family pictures and a christening dress when it improperly seized the home.

"It is difficult to imagine more deliberate, unwarranted and egregious conduct," Judge Catharine R. Carruthers wrote when sanctioning Countrywide.

When in the midst of her battle with the mammoth lender, Robin Atchley found Countrywide's behavior puzzling.

"I'm thinking 'Why are they trying to take our home?' " Atchley remembered. "We're making our payments --- why?"

Atchley and her husband are surprised to find themselves as players in what may turn out to be a ground-breaking legal challenge. But they do not mind playing that role.

"I hate to see anything bad or negative happen to anybody," Robin Atchley said. "I don't wish that on anyone. But you know, they deserve it."

CAPTION: ALLEN SULLIVAN / Staff John and Robin Atchley at the house they lease. A dispute with Countrywide forced them out of their first home.

CAPTION: ALLEN SULLIVAN / Staff John and Robin Atchley are surprised to find themselves as players in what may turn out to be a groundbreaking legal challenge.

Credit: STAFF

TESTIMONY OF

STEVE BAILEY

CHIEF EXECUTIVE FOR LOAN ADMINISTRATION

COUNTRYWIDE FINANCIAL CORPORATION

Before the

SENATE JUDICIARY COMMITTEE

SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

UNITED STATES SENATE

MAY 6, 2008

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Thank you, Chairman Schumer and Ranking Member Sessions, for the opportunity to speak with you today to address your concerns with respect to bankruptcy servicing and foreclosures. Countrywide is committed to helping our borrowers avoid foreclosure whenever they have a reasonable source of income and a desire to remain in the property. Further, I want to assure this Subcommittee that Countrywide also is committed to being supportive of the bankruptcy process when used by borrowers who are experiencing significant financial hardship to help them sustain homeownership. A successful Chapter 13 plan is in everyone's interest – the borrower's, the investor's, and the mortgage servicer's. Recent media reports alleging that mortgage servicers are systematically charging excessive fees and using the bankruptcy process to push borrowers into foreclosure or abusing the process more generally are inaccurate. Moreover, those claims run completely counter to Countrywide's commitment to help borrowers avoid foreclosure whenever feasible.

Today's market conditions have created unprecedented challenges for servicers and mortgage investors to develop new methods to help keep as many borrowers in their homes as possible. Countrywide recognizes and appreciates the goal of a Chapter 13 bankruptcy to provide borrowers with a fresh start and the opportunity to retain their most valued asset, their home. Countrywide is committed to cooperating with its borrowers who seek protection through the bankruptcy process and working with them to successfully complete a court-approved plan. Accordingly, Countrywide has always strived to accurately report and reflect the amounts due from borrowers so they can complete their bankruptcy plans and avoid foreclosure altogether.

My testimony will highlight recent enhancements we have implemented or are in the process of implementing relating to our bankruptcy servicing that focus on three objectives: *Transparency*, *Accuracy* and *Integrity*. The changes are designed to improve the disclosure of

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fees, ensure the accuracy of all amounts charged and ensure the integrity of the entire process. Countrywide's three point plan evidences our commitment to continuous improvement. This plan includes:

- An *Independent Review* by a qualified outside auditor on a random sample of loans in bankruptcy focusing on the accuracy of pre- and post-petition filings and the accounting for plan payments.
- Establishment of the *Bankruptcy Ombudsman's Office* to ensure that borrowers and their counsel can have a means to seek a high level review of any perceived discrepancies on accounts in bankruptcy.
- Adoption of certain *Best Practices* recommended by the National Association of Chapter 13 Trustees.

These initiatives are discussed in detail later in my testimony.

Mortgage Servicing and the Bankruptcy Process

I would like to discuss the basic process surrounding bankruptcy filings and subsequent mortgage servicing requirements to give context to this testimony. Most borrowers who file for Chapter 13 bankruptcy have reached a point where they have fallen behind in making payments to their mortgage loans. Indeed, many borrowers are often so far in default that the foreclosure process has already begun prior to their filing bankruptcy. By filing for bankruptcy relief they are hoping to establish a bankruptcy plan that allows them to pay back their debt and avoid foreclosure. Once a borrower files bankruptcy, there are certain limitations placed on a servicer's subsequent communications with the borrower going forward.

After a borrower files bankruptcy, the servicer retains an attorney to file a proof of claim to identify the amounts the borrower owes. Typically, the majority of the amount reflected in a proof of claim is comprised of the prior unpaid principal and interest payments. The proof of claim may also include back taxes or insurance payments the loan servicer has already advanced on behalf of the borrower. If the borrower had been severely delinquent or in foreclosure prior to filing bankruptcy, the proof of claim may also include fees and costs incurred by the servicer for foreclosure attorneys' fees or inspection costs. These items are called pre-petition amounts. At that point, the borrower, the borrower's attorney, and the trustee have an opportunity to review the amounts claimed and to raise any disagreement with the amounts presented. The delinquent pre-petition amounts are included in the borrower's bankruptcy plan, which is approved by the court. Notwithstanding the Chapter 13 bankruptcy and the confirmation of the plan, the borrower in most instances is still required to continue to pay ongoing mortgage obligations as they come due and to pay the taxes and insurance due on the property either directly or through an escrow established in connection with the loan. These amounts are called the post-petition debt.

Unfortunately, there are times when borrowers fall behind on their post-petition loan payments or their plan payments or both. Some borrowers make only partial loan payments over time; some borrowers skip loan payments entirely for a few months; and some borrowers fail to pay their taxes or insurance, requiring the servicer to advance those costs and seek their recovery from the borrower. In addition, plan payments routed through the bankruptcy trustee often come to the servicer irregularly, in amounts that bear no relationship to what is expected, and sometimes in checks that lump together the payments on many unrelated borrowers' accounts. We strive to do our best to accommodate these varied situations. At the same time, the servicer has an obligation to protect the investors' interests, who have a right under their contracts and the borrowers' plans to expect timely and full payments.

The uneven flow of payments causes servicers like Countrywide to incur further fees and costs in a borrower's bankruptcy. For example, when a borrower falls substantially behind on post-petition loan payments, a servicer typically requests that the bankruptcy court grant relief from the bankruptcy stay so the servicer may move forward with default proceedings. This requires the servicer to retain an attorney and incur third party fees. Sometimes, in response to the motion for relief from the stay, the borrower then makes the back payments and becomes current. Some borrowers become current after one motion has been filed, only to fall behind again, requiring yet another motion to be filed. In other situations, the borrower does not become current, and a court may grant the servicer relief from the automatic stay so that the servicer may proceed with default proceedings. Servicers prefer to continue to work with borrowers to bring their loans current; however, these actions are necessary to protect certain rights under the mortgage on behalf of the investor.

There have been a number of allegations made public in the press recently relating to the bankruptcy servicing practices of Countrywide and other servicers. Bankruptcy servicing is a complex process and involves the kind of legal proceedings I have mentioned, and possibly others. Moreover, the rules governing the bankruptcy process vary significantly across bankruptcy jurisdictions, from district to district and judge to judge. As a result, bankruptcy loan servicing is, by necessity, a borrower-by-borrower process as each circumstance is different. As such, to some unavoidable extent, the servicing process requires manual input or by-hand processing of data unique to each borrower. This type of processing can result in mistakes from time to time. However, those mistakes are few in number. Countrywide has completed a number of internal reviews that indicate an error rate of less than one percent for mistakes that adversely impact a borrower. As I will describe later in my testimony, Countrywide is implementing a three point plan to help us further increase this accuracy rate. However, many of the issues for which Countrywide and other lenders are being criticized arise in the first instance as a result of a Chapter 13 debtor not making timely post-petition loan payments, as required under the borrower's bankruptcy plan.

As noted above, complications arise when a borrower is unable to meet his or her post-petition Chapter 13 obligations even when given a grace period of several weeks or, in some cases, months following the due date. Chapter 13 does not relieve a debtor of the obligation to make timely post-petition payments. When they fail to do so, the only remedy available to the lender is to file a motion for relief from stay. Sometimes, a debtor will make a late payment at or shortly after the time that Countrywide refers a matter to its attorney to file a motion for relief from stay. This creates a situation where a motion for stay relief may be filed at almost the same time that the late payment is received from the borrower. In such cases, Countrywide withdraws the motion for relief.

Servicers have also been accused of intentionally assessing inappropriate fees and costs to borrowers in bankruptcy. With respect to Countrywide, these allegations are simply not true. Most of the arrearage amounts that accrue on a post-petition bankruptcy account are the result of unpaid principal and interest, taxes and insurance not previously paid by the borrower and advanced by the servicer, increases in a borrower's contractual interest rate on variable rate loans, or attorneys' fees and costs incurred by the servicer and payable to third party law firms as a result of motions for relief from the bankruptcy stay. Countrywide's policies and practices are designed to avoid incurring unnecessary fees on accounts, particularly those in bankruptcy, for example:

- Countrywide *does not* charge late fees on post-petition delinquencies. Countrywide forgoes these fees even though we are contractually allowed to collect them. Many other servicers do charge these fees.
- Countrywide *does not* collect pre-payment penalties on payoffs for loans in bankruptcy, though contractually allowed to do so.
- Countrywide generally waits *45 to 60 days into a post-petition delinquency*, depending on the requirements of the investor, before referring post-petition delinquent accounts to attorneys to file motions for relief. Rather than filing a motion for relief as soon as we are entitled to do so, Countrywide avoids raising costs to the borrower or the investor.

Countrywide is aware that some of the counsel it uses in certain districts have been criticized in other cases for the work they have performed. I can tell you that Countrywide takes these criticisms very seriously. Countrywide must rely on outside counsel to file pleadings in bankruptcy matters – it cannot represent itself in all aspects of a case -- and we expect our lawyers to follow all laws, regulations and individual court rules and policies, and to present the proofs of claim accurately. We evaluate our lawyers and law firms for quality and effectiveness, and make changes when necessary, including penalizing and terminating attorneys or law firms that do not meet our standards.

Recent Enhancements to CHL's Bankruptcy Servicing

As I have stated, because of the detailed bankruptcy accounting necessary and the varying rules in different bankruptcy jurisdictions regarding the information that can be provided to the borrower about pre- and post-petition debt, servicing loans for borrowers who are in bankruptcy is a very manual, individualized process. Countrywide is one of the largest mortgage servicers and accordingly handles a large bankruptcy portfolio – upwards of 65,000 ongoing cases at any one time. Although we have observed a low error rate, on occasion employees in Countrywide's bankruptcy servicing department make mistakes. Countrywide is committed to reducing the number of opportunities there might be for individual employee errors. To that end, over the past year we have implemented new policies and procedures, increased the number of employees within the relevant departments, and provided for greater checks and balances to minimize these errors. If we do make a mistake, the borrower's account records will be corrected and a refund will be paid if necessary.

Transparency

One key goal of Countrywide's policy revisions is to increase the transparency of the charges to the borrower. This includes providing borrowers with substantially enhanced notice to keep them accurately informed of their payment status, within the limits of the various laws and rules governing communications with debtors in bankruptcy. Though not required to do so on delinquent accounts involved in a bankruptcy, Countrywide now conducts an escrow analysis on each loan shortly after a bankruptcy filing date and will do so at least once during every 12 month period thereafter. In jurisdictions where such notification is allowed, Countrywide then sends resulting payment change notifications to the debtor, the debtor's attorney, the trustee and Countrywide's counsel.

Accuracy

Countrywide has also created a Validation Team to review each proof of claim, motion for relief from stay, or other document to be filed with a Bankruptcy Court. The Validation Team also performs an audit of each loan after the bankruptcy case is over, and before the loan is released from our Bankruptcy Servicing Department. There will be occasions when the loan is in delinquent status at that time, such as if the borrower failed to make his or her most recent payment on the post-petition debt, and thus will be transferred from the Bankruptcy Servicing Department to our collections or foreclosure groups. However, if the loan is leaving the Bankruptcy Servicing Department in a delinquent status, it will require approval at the Vice President level or higher to validate the delinquency and that such a transfer is appropriate. This will ensure loans are not being improperly referred from the Bankruptcy Servicing Department for collection activity or foreclosure on amounts discharged by the bankruptcy.

In addition, Countrywide is making technological enhancements to our cash management application by re-programming the servicing platform to more accurately track pre-petition and post-petition balances during the bankruptcy. This process is well under way with a goal of implementation by December 2008. We expect this technological improvement will further reduce the possibility of human error.

Integrity

In a further effort to ensure the integrity of our bankruptcy servicing process, today we announced a three point plan to validate our processes and assure continuous improvement. Countrywide will undertake these three new major initiatives to ensure we are doing everything we can to accurately monitor and service the loans of borrowers in bankruptcy:

- **Independent Review:** Countrywide will retain a qualified independent auditor to review a number of randomly selected loans in which the borrower has been in bankruptcy at any point within the last 3 years. The examination will focus on the accuracy of our bankruptcy accounting for pre and post-petition payments. The audit will also review the accuracy of pleadings filed in bankruptcy matters, including but not limited to motions for relief from stay and proofs of claim. If the audit identifies mistakes that caused a loss to borrowers, affected borrowers will be compensated or their accounts adjusted. Further, we will work with the independent auditor to determine if additional enhancements are necessary to improve our processes, and we will take steps to quickly implement appropriate recommendations.

- **Bankruptcy Ombudsman's Office:** Countrywide will establish the *Bankruptcy Ombudsman's Office* to ensure that borrowers and their counsel will have a means to seek a high level review of disputes in the bankruptcy servicing process. Going forward, the Ombudman's Office will be a resource for borrowers in bankruptcy to initiate a review of their Countrywide bankruptcy servicing records, if they or their counsel believe they have been charged fees in error or otherwise adversely affected by allegedly improper actions by Countrywide during the bankruptcy process. The Ombudsman's Office will research individual matters and, if Countrywide has made an error that has caused a loss, will make appropriate refunds or account adjustments.
- **Best Practices**: Finally, Countrywide will continue to assess and enhance systems, internal controls, and compliance programs to ensure the accuracy of our proofs of claims, motions for relief from stay and other filings in bankruptcy cases, and all charges imposed on borrowers in connection with the servicing of these accounts during bankruptcy. As you may know the National Association of Chapter 13 Trustees is developing a set of "best practices" for bankruptcy servicing. We have reviewed the NACTT's draft "Best Practices for Trustees and Mortgage Servicers in Chapter 13" and we intend to adopt those suggested

standards that are legally and contractually permissible for us, that enhance the efficiency of the bankruptcy servicing operation, and that protect the interests of our borrowers. We will work with the NACTT to ensure that the proposed best practices do not increase costs for borrowers in bankruptcy by causing unnecessary attorney involvement and associated fees.

The Intricacies of Bankruptcy Servicing Warrant Uniform Bankruptcy Court Rules

As noted above, the unique issues associated with each loan in bankruptcy make servicing these local rules, practices, and case law in the many bankruptcy courts are often different and conflicting. We believe that a cooperative effort by industry, the NACTT and all bankruptcy jurisdictions to create uniform processes and procedures will result in better customer service, more accurate filings and a more sensible system.

This lack of uniformity across jurisdictions is most evident in the following areas: notice requirements and recoverability of attorney's fees and costs.

Notice Requirements

Depending on the jurisdiction, courts suggest or require different notice requirements to preserve a servicer's right to collect post-petition amounts. Many jurisdictions are completely silent on this issue, other jurisdictions have decisions on the point, and still other jurisdictions have issued local rules. The differences can be highlighted by a review of two recent orders from bankruptcy courts in Vermont and Kansas. Vermont does not require a mortgage servicer to send monthly statements to the Chapter 13 trustee. Kansas, on the other hand, requires the mortgage servicer to send such statements to the Chapter 13 trustee when an adjustable rate on the debtor's mortgage is about to change. Kansas also requires the mortgage servicer to send a quarterly notice to the debtor and Chapter 13 trustee, detailing upcoming changes in an adjustable rate, charges paid by the servicer for taxes, insurance, attorney's fees, or other expenses, the nature of the expense, and the date of payment. Vermont does not. The law is not clear on these issues generally, to the point where Countrywide, along with a half dozen other major loan servicers, are defendants in a class action in Ohio where we are being sued for sending monthly mortgage statements at all.

Attorneys' Fees and Costs

Another example of the variation among the courts concerns the recoverability of attorney's fees and costs incurred by a mortgage servicer, and the proper procedure for recovering such fees and costs. Vermont and Kansas do not require court approval if the servicer follows detailed notification procedures for identifying fees and costs owed by the borrower. Other jurisdictions, such as California, allow such fees and costs to be listed on the proof of claim. At least one court in Florida has refused to allow such fees to be paid in the bankruptcy, but stated that the fees could be recovered from the borrower in full after the case is over. Still other bankruptcy courts, such as in North Carolina, interpret the Federal Rules of Bankruptcy Procedure as requiring mortgage servicers to file formal applications and obtain formal court approval before recovering fees and costs. Though some courts believe fee applications are helpful, such applications, if taken to extremes, can result in higher fees and costs to the debtor and servicer because the cost of the application itself is a recoverable cost.

Countrywide respects and strives to abide by all courts' orders and requirements for servicing loans in bankruptcy. Nonetheless, the variations imposed by different courts in different jurisdictions, while individually attainable, collectively create an environment more susceptible to human error. Countrywide understands that servicers must be diligent to avoid errors that could be injurious to the borrowers. As noted above, Countrywide conducted a number of internal reviews of its bankruptcy servicing and found that errors adversely impacting borrowers are at a rate of less than 1%. Nevertheless, we are committed to doing even better. Countrywide's 3 step plan discussed above, including a further audit, an ombudsman program and continuous improvement through implementation of further best practices will help us further reduce avoidable errors. We also believe that consumers and the industry as a whole would benefit from a uniform set of rules that are applicable across all bankruptcy courts to establish consistent procedures.

Thank you.

News From:

U.S. Senator
Russ Feingold

506 Hart Senate Office Building
Washington, D.C. 20510-4904
(202) 224-5323

http://www.senate.gov/~feingold

FOR IMMEDIATE RELEASE – May 6, 2008
Contact: Zach Lowe & Katie Rowley - (202) 224-5323

Opening Statement of U.S. Senator Russ Feingold

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

Senate Judiciary Administrative Oversight and the Courts Subcommittee

As Prepared For Delivery

"While Wisconsin has not been as hard hit as other regions of the country by the subprime mortgage crisis, foreclosures are on the rise in the state and more and more I hear concerns back home about the effects of rising number of foreclosures on our communities. I have heard from local government officials who are concerned about holding lenders accountable for maintaining abandoned homes and ensuring the abandoned homes do not fall into disrepair. I have heard from housing advocates concerned about borrowers who may have been misled into taking out a subprime loan and now face the prospect of losing their homes. And I have heard from dedicated lawyers and counselors who are trying to provide counseling and other services in order to help individuals and families through these tough times. Helping families avoid foreclosure should be a top priority of Congress.

"For some families, bankruptcy provides an entirely legitimate way to prevent foreclosure. This is exactly the purpose of Chapter 13 – to let people pay their past due debts over several years under the supervision of the court and the trustee so they can stay in their homes. When foreclosure is avoided, everyone wins – lenders get paid, families aren't uprooted, property values are protected, and communities are strengthened. Of course, if Congress continues to refuse to give bankruptcy courts the power to modify the terms of subprime mortgages, even going into bankruptcy will not help some families. But it can still work in some circumstances.

"That is why it is so shocking and disheartening to learn of the abuses of the bankruptcy process by mortgage servicers. At the very point when families are trying to straighten out their affairs and do the right thing by their creditors, including those who hold their mortgages, they are being taken advantage of and pushed again to the brink of foreclosure. These abuses, or even mistakes, if that's what they are, are inexcusable. We know that some businesses will profit from these tough economic times. That's probably unavoidable. But to cheat and steal from hardworking people who are down on their luck and are trying to do the right thing is just unacceptable.

"I'm also concerned that what we are beginning to learn about the practices of these companies may not be limited to bankruptcy cases. Millions upon millions of Americans have mortgages. They are told how much they owe, and they pay it. Month after month after month. They assume that the

1600 Aspen Commons
Middleton, WI 53562
(608) 828-1200

517 E. Wisconsin Ave.
Milwaukee, WI 53202
(414) 276-7282

First Star Plaza
401 5th St., Room 410
Wausau, WI 54403
(715) 848-5660

425 State St., Room 225
La Crosse, WI 54601
(608) 782-5585

1640 Main Street
Green Bay, WI 54302
(920) 465-7508

calculations of the mortgage servicing companies are correct and that their payments are properly credited. Very few people have the ability to analyze the amounts listed on their payment coupons or their annual statements and figure out if they are accurate. And if they start having trouble with their payments, most people can't determine whether the fees and charges they are assessed are legitimate.

"I commend the U.S. Trustee and the Chapter 13 trustees for putting more effort into scrutinizing these cases and the claims of these servicing companies, and I applaud the bankruptcy judges who have used their power to sanction companies and law firms that engage in improper practices. The Department of Housing and Urban Development needs to do more to address these issues. But I think it's also pretty clear that changes in the law are needed as well to help the trustees and judges recognize and stop these tactics and to provide the kind of sanctions that are needed to deter them. I am prepared to work with you, Mr. Chairman, on legislation, and I hope the Judiciary Committee will take the recommendations that come out of this hearing very seriously."

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STATEMENT OF SENATOR CHUCK GRASSLEY FOR JUDICIARY ADMINISTRATIVE OVERSIGHT AND THE COURTS SUBCOMMITTEE HEARING ON ABUSIVE MORTGAGE PRACTICES IN BANKRUPTCY, MAY 6, 2008

Thank you, Chairman Schumer and Ranking Member Sessions, for holding this hearing today. We've seen quite a few news reports about abusive and questionable practices by mortgage servicers, lenders and their attorneys during bankruptcy proceedings. Furthermore, the U.S. Trustee program has filed allegations in bankruptcy court that certain mortgage servicing companies and their attorneys have submitted inaccurate court documents, and charged fees against debtors that were undisclosed and/or impermissible under the terms of the loan contract or other applicable law. I do think the legal processes need to work themselves through. Many of these charges are still being litigated in court, and the U.S.

Trustee is still investigating others. Certainly the home mortgage lending and servicing system is complex and we need to understand it better. But there are enough cases where bankruptcy judges have ruled against the mortgage servicers, mortgage lenders and their attorneys, to lead me to believe that Congress needs to be looking very closely at whether the bankruptcy laws provide adequate protection against these abuses and whether we should be beefing up our laws against these practices.

Congress needs to determine whether there is a deliberate effort on the part of mortgage service companies, mortgage lenders and their lawyers to engage in wrongdoing, or whether there is a widespread pattern or practice of negligence and sloppiness. If the evidence establishes that the conduct of mortgage servicers, lenders and lawyers has been deliberate and intentional, then perhaps

Congress needs to further enhance penalties and tighten up creditor filing requirements.
If the evidence shows that mortgage servicing companies, lenders and lawyers have been highly negligent and sloppy, Congress needs to figure out how to promote responsible behavior while recognizing that a negligent pattern of conduct can become intentional if the bad actors are given an opportunity to change their ways and they don't.

I'm in favor of more disclosure when it makes sense and doesn't confuse the situation even more. Moreover, I'm in favor of more disclosure if innocent debtors are helped and wrongdoing by creditors is exposed. I'm also in favor of imposing additional penalties to deter abusive and predatory behavior, especially if there is widespread abuse of the system.

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I'm pleased that the U.S. Trustee has been aggressive about investigating and pursing allegations of abuse and wrongdoing, be it by creditors, debtors, or bankruptcy attorneys working for either side. I'm particularly pleased by the actions of the U.S. Trustee to protect debtors who are on the verge of losing their homes in bankruptcy because of sleazy tactics and opportunistic misconduct by creditors and their lawyers.

One of the main goals of the bankruptcy reform law we passed in 2005 was to shore up the integrity of the bankruptcy system. I think that the U.S. Trustee's efforts at conducting more oversight of the accuracy of bankruptcy filings is a good thing for the bankruptcy system, for the public, and for borrowers and lenders.

Another goal of the 2005 bankruptcy reform law was to make the bankruptcy system more fair – to require people who can repay their debts do just that, repay their debts, while maintaining a safety net for those debtors who don't have an ability to repay their debts. However, if creditors are taking advantage of the system, and are fraudulently and intentionally ripping off innocent debtors who are trying to get a fresh start in bankruptcy and who are playing by the rules, well, that is unfair and we need to put a stop to it. If creditor lawyers file inaccurate papers and are sloppy, and debtors are trapped into a foreclosure on their homes, that's unacceptable. I believe that the bankruptcy law contains provisions that already prohibit and punish this kind of activity, but I'm certainly open to hearing whether we need to beef up our laws to protect debtors who are being preyed on as they try to find relief in bankruptcy.

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So I look forward to hearing testimony from the witnesses here today. In particular, I'd like to welcome Associate Professor Katherine Porter from Iowa University Law School, who is here to discuss her recent research paper, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*. I think this is a very valuable study about what is going on relative to mortgage claims in bankruptcy. As an aside, Ms. Porter was an intern in my office back in 1994 while she was in college, and staff who worked with her remember her fondly. Welcome back to Washington, DC, Katie.

Chairman Schumer, again thank you for holding this hearing. I have a number of conflicting appointments this afternoon, so I'll have to leave the hearing early. However, I intend to review the record carefully and may submit written questions to the witnesses.

TESTIMONY

OF

Debra Miller
Standing Chapter 13 Trustee
P.O. Box 11550
South Bend, IN 46634-0550
Email: dmiller@trustee13.com

CHAPTER 13 STANDING TRUSTEE
FOR THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF INDIANA, FORT WAYNE AND SOUTH BEND DIVISIONS

BEFORE

THE SENATE JUDICIARY SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT

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

May 6, 2008

Mr. Chairman and Members of the Subcommittee:

I am Debra Miller. I serve as the Chapter 13 trustee in the Northern District of Indiana. In my capacity as a Chapter 13 trustee, I have joined with my colleagues as we work with hundreds of families as they struggle to keep their houses in the face of foreclosure. We work with mortgage companies as they seek to recover the funds to which they are legally entitled.

I also serve as the Chair of the National Association of Chapter Thirteen Trustees (NACTT) Mortgage Liaison Committee, a special working group, established by the NACTT, to work with all participants in the mortgage process to develop ways to improve Chapter 13 procedures and perhaps help borrowers keep homes and mortgagers receive payment.

Thank you for the opportunity to appear here today to inform you of the activities of the NACTT mortgage liaison committee.

Chapter 13 trustees have a unique role in the world of bankruptcy. Trustees are appointed by the Department of Justice to administer the Chapter 13 bankruptcies in their district. There are approximately 210 trustees throughout the country. In the 2007 fiscal year, the Chapter 13 trustees across the country distributed over $5.1 billion dollars to creditors. More than half of us paid post-petition mortgage payments through our offices.

Generally, Chapter 13 debtors are behind in their mortgage payments prior to filing. In many cases, a Chapter 13 bankruptcy is filed as a last resort to save the family home from foreclosure. Chapter 13 allows those debtors to reorganize their finances, cure the arrearages owing on their mortgages while they maintain ongoing monthly mortgage payments. The goal is that at the end of the Chapter 13 case, the borrower's mortgage is current and there remain no outstanding fees, costs or other issues that would stop the debtor from receiving their fresh start.

Chapter 13 trustees and their staff review the documents and legal pleadings filed by debtors, creditors and other parties in interest. Chapter 13 trustees often act as mediators and arbiters to ensure that all parties comply with the Bankruptcy Code and Rules. In other words, our job is to make sure that everyone plays fairly and by the rules.

In this role, we observe systemic problems in the mortgage servicing industry. While the bankruptcy is pending, we see mortgage servicers file Motions for Relief from Stay alleging the debtor is delinquent on their payments. Even though records indicate that the payments to the mortgage creditor are current. Trustees try to obtain information from servicers or the servicer's counsel, only to receive confusing, incomprehensible and incorrect records, if records are furnished at all. Debtors call our offices noticeably upset when they receive a notice from their mortgage servicer, years after successfully completing a repayment plan, showing they owe more money on their mortgage than when they filed the bankruptcy. Debtors tell us of demand letters for thousands of dollars and accuse us, their attorneys and the bankruptcy system for denying them the fresh start the Bankruptcy Code promises.

There are many causes for these issues:

- Trustees have not been advised of mortgage payment changes or advised about changes until years after the payment changed. At the end of the bankruptcy – perhaps months after the debtors receive a discharge – the mortgage account may be reviewed by the servicer and only then a demand made directly to the debtor for an accumulated shortfall.
- Proofs of claim filed in bankruptcy are often incorrect, failing to show who actually owns a loan and/or may include exorbitant fees, costs and charges, which inflated the amount due to the mortgage servicer. Such fees, costs and attorney fees claimed due and owing are often not itemized, revealing only some amount as a "corporate advance."

  In one case, while clearly an error, the servicer filed a proof of claim for $63,665.83 and included $151,987.75 in "inspection fees", $38,483.63 in Foreclosure Fees and $38,020.00 in broker price opinions and over $13,449.00 in interest. The error was compounded, however, when the debtor's attorney and trustee's office were unable to communicate with the servicer or its attorney. The servicer failed to correct its clearly erroneous proof of claim even after objection was raised. The court, frustrated with the inability to resolve the issue and the repeated failure of the attorney and servicer to appear in court when ordered, directed the U.S. Marshals to bring the attorney from across the country so he could explain his actions to the court.
- Some servicers fail to abide by the requirements of the Real Estate Settlement Procedures Act (RESPA) by failing to analyze a loan to determine whether the required monthly payments could satisfy principal, interest, insurance and taxes. At the conclusion of the bankruptcy, the mortgage account is analyzed and only then a demand made for any shortfall.

  For example, there is now litigation pending where the debtor made every payment timely to my office, I made every payment timely to the servicer including paying off the amount the borrower was behind on the mortgage at confirmation, only to be advised that the borrower owed an additional $4,000 which should be paid in order to be current prior to discharge. The servicer, when asked for copies of the escrow analysis conducted during the life of the bankruptcy, advised me, on the Office of the President letterhead, that it did not conduct any analysis on any loan while a borrower was in bankruptcy. This has resulted in every Chapter 13 debtor whose loan was serviced by this nationwide servicer immediately receiving a demand for these sums upon the discharge of their cases.
- Trustees are unable to locate, therefore communicate with, servicers during the pendency of a bankruptcy. Servicers often do not supply phone numbers on claims or to the trustees. Trustees and/or debtors call the main customer service numbers, only to wait for hours in a surreal telephone queue, then are told that the person answering the call can't or won't help.

  I can't tell you how many times I have held, been transferred from extension to extension, only to be frustrated when no one can or will tell me the status of a loan or even what the monthly payment should be.
- Payments are not properly credited to the debtor's mortgage. Trustee checks are often returned without explanation or are cashed, but funds are never applied to the debtor's mortgage. This generally results in the filing of a Motion for Relief from Stay alleging that the debtor is behind on the mortgage when the Debtor is actually current.

- Late fees, inspection fees or other "contractual costs" are added to the mortgage during the life of the bankruptcy without notice to the debtor, the debtor's attorney or the trustee. While some fees and costs are legitimate, some appear to have no basis in the contract or under applicable law. The end result is that, without providing notice of asserted charges, debtors and trustees are incapable of challenging whether the charges are reasonable or appropriate and are unaware that they are even due.
- If a servicer does analyze the mortgage loan during the bankruptcy, it often "double dips." For example, a servicer files a proof of claim for a $600 prepetition charge, asking the court to require the trustee to pay that sum during the bankruptcy. Then, the servicer increases the ongoing monthly mortgage amount by $50 a month to also recover that cost. The servicer receives the $600 twice -- once from the trustee through the bankruptcy plan as a separate claim and once in the increased monthly mortgage payment.

Courts are required to have hearings on Motions for Relief from Stay when mortgage servicers assert that Debtors are delinquent in their payments, even though a Trustee can demonstrate that payments are actually current. Trustees attend the hearings with records showing that all the required payments have been made and can provide cancelled checks as proof. Unfortunately, debtors who pay their own ongoing mortgage payments rarely have cancelled checks and it is difficult to prove that all the required payments have been made.

Trustees have discovered that servicers often claim additional funds are due and owing at the end of a case because of attorney fees, costs or advances made by the servicer during the life of the bankruptcy. These fees or costs are generally not disclosed to the Debtors when incurred and often place the debtor in a worse position and further behind on mortgage payments than when the case was filed. In an effort to combat this abuse, trustees have been taking actions to bring the status of the mortgage before the court prior to the end of the case.

After debtors obtain a discharge, they often get a bill from their servicer for amounts that have not been paid during the bankruptcy case. Sometimes they choose to walk away from a house, angry that they "wasted their time" by using bankruptcy to save their home. They blame the system, their attorney, the trustee, the court, and their faith in the legal system is destroyed.

Trustees, courts, and debtor's attorneys are understandably frustrated. It appears that some servicers flaunt the bankruptcy law and the court's jurisdiction over them.

Approximately six years ago, Henry E. Hildebrand, III, the Chapter 13 Trustee for Middle District of Tennessee, published an article entitled the "Sad State of Mortgage Servicing." This article outlined the issues and problems with the industry. It brought to a head the festering issue, infuriated some mortgage servicers, and led to some attorneys for servicers and a group of trustees to meet to "discuss" the article.

That discussion was the beginning of the NACTT Mortgage Liaison Committee.

Our committee began as a cooperative effort between trustees and attorneys for servicers to discuss procedural and administrative issues that arise for both parties when borrowers become debtors in Chapter 13 bankruptcy. Lines of communication began to open, employees of servicers were added to the committee and all parties learned that both were willing to work toward solutions.

Telephone conference calls and face-to-face meetings were held. Frank discussions explained what the servicers and trustee accounting systems could and could not do. Trustees relayed their frustration of the lack of communication. Servicers relayed their frustration with a federal bankruptcy system that was administered differently in each court.

As time has passed, more trustees and servicers participated, and the group grew large enough that it was split into subcommittees. The committee's mission was to foster communication between the parties, resolve differences and to recommend best practices of conduct for all stakeholders. Our collective goal is to improve the bankruptcy system.

In May 2007, we met for a face-to-face meeting in Columbus, Ohio. Over a two-day period, the committee members discussed what should be a "best practice" in various situations. We attempted to come up with practical solutions for issues facing the servicer of mortgage loans while the borrower is in a Chapter 13 bankruptcy. Our collective efforts were put in writing.

What are Best Practices? Best Practices are management ideas which assert that there are techniques, methods and processes that are more effective at delivering a particular outcome. The idea is that with proper processes, a desired outcome can be delivered with fewer problems and unforeseen complications. Best Practices are not the only way to achieve a desired goal -- there may be other procedures that deliver the same outcome – however they are an acceptable and efficient way of accomplishing a task, based on repeatable procedures that have proven themselves over time.

Some of the Best Practices suggest a procedure that was not used in many jurisdictions – such as the servicer filing a notice with court when a mortgage payment changed or a fee or cost was assessed. Some Best Practices simply restated what the committee believed the law required -- such as analyzing the loan each year for negative escrow issues.

After the Best Practices were initially drafted, the committee approached the judiciary and the attorneys for the debtors. We wanted to have a set of Best Practices in place that would be accepted by all parties. A few judges participated in the committee's phone conferences. The Best Practices were distributed and comments made. Some Best Practices were found to be not acceptable or so contrary to current case law as to not be feasible. Additional issues were raised and were placed on the agenda for the next set of best practice discussions. The Best Practices were distributed to debtor's attorneys' groups for comments. Again, some Best Practices were found not to be acceptable and were dropped or revised.

In the fall of 2007, committee members met in another face-to-face discussion with various members of the judiciary and debtor's counsel to attempt to finalize the Best Practices.

The Best Practices have now been presented at meetings of the National Conference of Bankruptcy Judges (NCBJ), the Mortgage Bankers Association (MBA), American Financial Network (AFN) and United States Financial Network (USFN).

So what are the current approved Best Practices?

Proofs of Claim

- When servicers/mortgagees include a flat fee cost in the proof of claim for review of the Chapter 13 plan prior to confirmation and for the preparation of the proof of claim, the fee should be reasonable and fairly reflect the attorney (outside counsel) fees incurred.

- Servicers/mortgagees should not include any prepetition costs or fees or prepetition negative escrow in any post petition escrow analysis. Such amounts should be included in the prepetition claim unless the payment of such fee or cost was actually made by the servicer after the date of the filing of the bankruptcy.

- Servicers/mortgagees should state mortgage arrearage up to the date of the filing of the bankruptcy petition, unless the plan or trustee indicates otherwise, or local rule provides otherwise. The Chapter 13 Trustee will use the mortgage arrearage claim to set up the arrearage balance on the claim, which in turn will show up as the "balance" on the voucher check, absent objection to the claim.

- Servicers/mortgagees should clearly identify if the loan is an escrowed or escrowed loan and break out the monthly payment consisting of Principal, Interest, Escrow and PMI components.

- Servicers/mortgagees should identify nontraditional mortgage loans in their proof of claims. Loans with options should identify on the proof of claim the type of loan as well as the various contractual payment options available during the bankruptcy to the borrower/Debtor.

Payment Application

- Pre petition payments should be tracked as applied to pre petition arrears, post-petition payments should be tracked as applied to post petition ongoing mortgage payments

- Prior to the filing of a Motion for Relief from Stay in a Trustee pay jurisdiction, the trustee website or the National Data Center website should be reviewed.

Post Petition Costs and Claims

- Servicers/mortgagees should file a notice and reason of any payment change with the court and provide same to the Debtor.

- Servicers are required to file a notice of any protective advances made in reference to a mortgage claim, such as non escrow insurance premiums or taxes. Such notice should be provided to the debtors and filed with the court.

- If Servicers/mortgagees include attorney fees for pursuing relief from stay, such fees should be clearly identified as well as how such fees are to be paid in any agreed order resolving a Motion for Relief from Stay or any other matter before the court.

- Servicers/mortgagees should analyze loans for escrow changes upon the filing of a bankruptcy case and each year thereafter. A copy of the escrow analysis should be provided to the debtor and filed with the Bankruptcy Court by the servicers/mortgagee or their representative each year.

- Servicers/mortgagees should attach a statement to a formal notice of payment change outlining all post petition contractual costs and fees not previously approved by the court and due and assessed since the prior escrow analysis or date of filing whichever is later. This statement need not contain fees, costs, charges and expenses that are awarded or approved by the Bankruptcy Court order. In absence of any objection or challenge to such fees, the trustee should take appropriate steps to cause such fees to be paid as part of Debtor's Chapter 13 plan.

- Mortgage servicers should monitor post petition payments. If the mortgage is paid post petition current then the servicers/mortgagees should not seek to recover late fees. No late fees should be recovered or demanded for systemic delay but should be limited to actual debtor default.

<u>Communication</u>

- Servicers/mortgagees should supply and maintain a contact for debtor's counsel and trustee's for the purpose of restructuring, modifying a mortgage, or other loss mitigation assistance including a short sale or deed in lieu of foreclosure. The contact should be an individual or group with the ability to implement or assess with objective criteria a loss mitigation modification after filing of a chapter 13 petition with the goal of keeping the Debtor in the house and the success of the bankruptcy.

- Mortgage servicers should provide a dedicated phone line and contact for Chapter 13 Trustee inquiry use only.

- Trustees should initiate a communication with mortgage servicers when questions arise in a review of a post petition escrow analysis.

<u>Education</u>

- United States Trustees and the Trustee Education Network should modify the requirements of the financial management class regarding adjustable rate mortgages, the calculation of mortgage escrows and, in particular, the potential of

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increased mortgage payments resulting from increased taxes, interest rate hikes and/or mortgage premiums.

The next step – Implementation.

Courts, local counsel and trustees throughout the country as they struggle with mortgage issues are using the Best Practices as a starting point for drafting local rules and plan provisions.

Servicers on the committee are reviewing their procedures, asking for the funds in their budgets to implement the Best Practices.

Servicers are reaching out to other servicers not on the committee to inform and discuss the Best Practices.

Trustees are conducting seminars for creditor and debtor attorneys, small local banks and mortgage servicers to discuss the Best Practices.

Trustees, servicers and their counsel are conducting informational webinars to inform general counsel and management of mortgage servicers of the Best Practices.

Courts are using the Best Practices as a tool to reform servicers' conduct in litigation arising from issues and possible misconduct.

Legislative and Administrative Assistance

We are also running into some unexpected roadblocks in implementing the proposed Best Practices, and we hope for your assistance.

We believe that notices of payment changes, assessment of fees and costs should be made with the bankruptcy court. This proposal is encountering resistance by some courts who refuse to accept these filings. We are trying to address this issue through the Bankruptcy Clerks' Committee and the Administrative Office of the United States Courts but it appears that a change to the Bankruptcy Rules may be required to allow this to be implemented nationwide.

Our Best Practices would encourage the analysis of each mortgage loan, but this may appear inconsistent with the murky language in the RESPA guidelines governing escrow analysis. We encourage clarification.

Our Best Practices related to the annual escrow statements should be a requirement under RESPA as some courts have found that simply providing these important notices to debtors in bankruptcy violates the automatic stay.

The GSE's Fannie and Freddie should be required to ensure that their servicers follow the Best Practices or have a procedure in place that accomplishes the same result.

We are pleased to work with this committee to further the implementation of our recommended Best Practices and to work with you to draft language to help in the implementation of these nationwide.

In closing, I wish to thank the Subcommittee again for the opportunity to provide information regarding the NACTT mortgage liaison's committee's Best Practices and our committee's attempt to begin to resolve the ongoing issues of problems with mortgage servicing in a Chapter 13.

Mr. Chairman, I would be pleased to answer any questions that you or members of the Subcommittee may have.

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Can These Mortgages Be Saved?

By GRETCHEN MORGENSON

ON Christmas Eve two years ago, as Shannon Rivas-Spivey wrapped gifts for her two young sons, she was interrupted by a knock at her door. Standing on her front steps in Somers Point, N.J., was a man from the Atlantic County sheriff's office, delivering foreclosure papers on the three-bedroom home that she and her fiancé, Harold Spivey, had owned for almost 10 years.

The visit was unwelcome, but not a surprise. Ms. Rivas-Spivey had been battling foreclosure for over a month, ever since the Countrywide Financial Corporation, the huge lender that services her loan, charged her escrow account for flood insurance she did not need and could not afford to pay. During the months it took to have Countrywide fix the error, she said, she fell behind on the loan.

Now the sheriff's office had come calling. "It totally destroyed our Christmas," she said. "I feel like a failure. I let my sons down, I let my dogs down. It's senseless."

There are two sides to every story, of course. Countrywide disputes Ms. Rivas-Spivey's contention that billing her for unnecessary flood insurance essentially forced her into foreclosure. It said it has worked extensively with her to rescue her loan from default but that its efforts have failed.

Such painful, personal and financially damaging tugs of war between lenders and borrowers are likely to continue for quite some time. As the home mortgage boom of recent years continues to deflate, hundreds of thousands of borrowers are facing escalating monthly bills on adjustable-rate loans that are either in foreclosure or near it. In August, according to RealtyTrac, a home loan database, foreclosure filings across the country — default notices, auction sales notices and bank repossessions — soared to almost 244,000, up 36 percent from the previous month and more than double the number in August 2006.

Lenders, government officials and loan servicers, who take in borrowers' monthly mortgage payments, contend that troubled borrowers everywhere are being helped to stay in their homes by those overseeing their loans. But neither data nor anecdotal evidence supports this view. A recent survey of 16 top subprime loan servicers by Moody's Investors Service found that for the first six months of 2007, an average of only 1 percent of loans experiencing an interest rate adjustment, or reset, had been modified.

Moody's did not identify the servicers it surveyed. But borrower advocates who work with a broad array of lenders say that none make it harder to modify loans than Countrywide, the nation's largest mortgage originator and loan servicer. Countrywide deploys a 2,700-member unit, called the HOPE Team, that it says helps borrowers modify their loans and hold onto their homes. HOPE is an acronym for "Helping homeowners, Offering solutions, Preventing foreclosures and Envisioning success," but some Countrywide borrowers say the company's practices have left them hopeless.

According to a dozen borrowers interviewed for this article, and thousands more who are working with borrowers' advocates, it is often difficult for homeowners to reach HOPE staff members. When they do, these people said, they encounter hostility and are charged large and unexplained fees throughout the foreclosure process — whether or not they wind up keeping their homes.

"Countrywide is trying to say they are doing workouts, but they are doing them with as little financial sacrifice for the company and as little effort as they can," said Senator Charles E. Schumer, Democrat of New York and a member of the Senate Committee on Banking, Housing and Urban Affairs. "They are trying to get away with doing a good job here when you can prove by digging even a half an inch deeper that they're not."

Countrywide strongly disagrees. Last week, it described its efforts on behalf of troubled homeowners. "Our No. 1 priority is to help borrowers stay in their homes," said Steve Bailey, a Countrywide executive, in a news release. The company said it has saved 39,582 mortgages from foreclosure so far this year.

But according to Countrywide's own data, it currently services almost nine million mortgages, with a value of $1.45 trillion. Of those, roughly 450,000 are delinquent. So providing home preservation assistance on the 39,582 loans amounts to just 8.8 percent of Countrywide borrowers who have fallen behind.

Even so, the workouts that Countrywide boasted about last week include two types of deals that wind up forcing borrowers from their homes. Almost 14 percent of its homeownership preservation efforts involved borrowers who agreed to sell their homes for less than their loan amounts, called a short sale, or involved homeowners turning over their deeds to Countrywide to prevent a foreclosure. Countrywide did not disclose in its news release that such arrangements were included in its workout figures.

"When you look under the surface, they are counting deeds-in-lieu as a modification," said Martin Eakes, chief executive of the Center for Responsible Lending, a nonprofit and nonpartisan research organization. "When you've taken someone's house, even without the foreclosure process, to count that as a modification is worse than fiction."

Mr. Bailey conceded that some might take that view but said in an interview, "At the end of the day, foreclosure avoidance is the theme we're going after."

AS the nation's largest lender and loan servicer, Countrywide finds itself in the middle of the mortgage storm and a target of borrower anger. In August, it reported that delinquencies in its servicing portfolio stood at 4.9 percent of its total outstanding loan amounts, up from 3.65 percent at the same time last year.

Foreclosures are not far behind. Expressed as a percentage of the loans' unpaid principal balances, they jumped to 1.2 percent in August from 0.48 percent a year earlier. Foreclosures pending as a percentage of total loans increased to 0.89 percent in August, up from 0.50 percent a year earlier.

To be sure, customers who borrowed from many lenders other than Countrywide are also experiencing difficulties with their loans. But because Countrywide was one of the most aggressive purveyors of adjustable-rate loans — the kind with interest rates that rise significantly after a low, two- or three-year teaser rate expires — it is not surprising, borrower advocates say, that overall problem mortgages are ratcheting up. The Mortgage Bankers Association said that adjustable-rate mortgages to subprime borrowers accounted for 44 percent of all new foreclosures in the second quarter of this year.

Even as Countrywide maintains that helping its borrowers modify their loans is its top priority, its investors have heard a slightly different story. In a conference call with analysts and investors in late July, Kevin Bartlett, Countrywide's chief investment officer, counted about 2,000 loan modifications done in June. Most of those, he said, involved deferring overdue interest or adding the past due amount to a loan. The company rarely provides workouts that reduce interest rates on loans, Mr. Bartlett told investors.

Yet reducing rocketing interest rates is exactly the relief that many borrowers are seeking because, consumer advocates say, that is the only way they can afford to stay in their homes. Loan experts say that when workouts involve deferring overdue interest or tacking amounts owed onto the back of a loan, borrowers often wind up in trouble again in just a few years.

Mr. Bailey said that while Countrywide has historically done few interest rate reductions, it will be doing more. "Right now we have just about 1,000 loans facing interest rate reductions," he said. "The pendulum is swinging that way."

But Mark Seifert, executive director of Empowering and Strengthening Ohio's People, a consumer advocacy group in Cleveland, is dubious. He said his experience with Countrywide, one of the dozen or so lenders and servicers with whom he works on behalf of borrowers, has been unsatisfactory.

For the first eight months of this year, he said, his group took in 132 cases in which Countrywide was the loan servicer. Of those, two ended up in what he called "very good" workouts from the company. One involved forged documents when the original loan was made, Mr. Seifert said, and the other involved a borrower who received her deal from Countrywide the day before she was set to testify before Congress last July about her problems with the company.

"We have experience with Citi, Chase and a whole litany of other lenders," Mr. Seifert said. "Some are better than others, but we are successful more than half the time with all of them. Except Countrywide."

Mr. Bailey said the views of Mr. Seifert and others reflected the fact that they were dealing with borrowers in duress. "We have had a lot of conversations with them and they don't like the answer we've given them," he said. "By the time the activist groups get involved in our loans, usually they are dealing with situations that are a little more grim."

Lenders in general, and Countrywide in particular, say that they have no incentive to let a home go into foreclosure because all parties — homeowners and those who hold their loans — typically lose money in a distress sale. A 2003 Federal Reserve study found that estimated losses on foreclosures range from 30 percent to 60 percent of the outstanding loan balance, as a result of legal fees, lost interest payments and property costs. Countrywide said it incurred $600 million in losses on loans it holds in the first six months of 2007.

But on the billions of dollars worth of mortgage loans that have been sold to investors in the last few years, it is not the banks or lenders like Countrywide that are hit with big losses when homes go into foreclosure. It is the sea of faceless investors who own pieces of these trusts. Also, under the trusts' pooling and servicing agreements, Countrywide and other servicers typically recoup any costs they cover in the foreclosure process, such as legal and appraisal fees.

Borrower advocates fear that fees imposed during periods of delinquency and even foreclosure can offset losses that lenders and servicers incur. Few borrowers know, for example, that when they make only partial payments on their mortgages, servicers do not credit those payments against the principal or interest on their loan. Instead, the partial payments are deposited into a so-called suspense account. Servicers can dip into these funds and make use of them as interest-free loans, although the funds have to be accessible when the borrower becomes current on payments. In the meantime, borrowers — whether or not they know it — are still zapped with fees and charges for delinquent mortgage payments.

"The foreclosure process is a profit opportunity for servicers and lenders, but there is very little oversight of the fees imposed," said Michael D. Calhoun, president of the Center for Responsible Lending. "There are a lot of folks trying to squeeze distressed borrowers."

JANE CONNOR, a Countrywide borrower who is a writing instructor at the Massachusetts Institute of Technology, certainly feels squeezed. In March, she says, she was forced from her Arlington, Mass., home, a three-story Victorian she bought in 1998 for $298,000. She fell behind on her mortgage in early 2006 after her husband lost his job and she learned she had breast cancer. Fremont General, a financial services concern, originated her adjustable-rate loan but Countrywide now services it.

Ms. Connor said her interest rate was around 11 percent and her monthly payments about $5,200 when she fell behind. In April 2006, with the principal balance on her loan at $442,645, because of a refinancing, she got a deal from Countrywide to pay around $5,000 in cash each month, payments she made on time in May, June and July of last year. But she says she was two days late in August, and Countrywide refused her payment.

"They told me I was $26,000 in arrears when I started making the payments," she said. "But they didn't accept the cash payment in August and when I called to ask about the problem, they said I had forfeited the workout arrangement by being two days late."

At that point, Countrywide said Ms. Connor was behind by $43,000, nearly $20,000 more than she was a few months earlier. She said she did not understand why the figure had grown so fast in such a short time. A look at her documents shows how quickly the owed amount can rise, thanks to fees and unpaid interest.

In April 2007, for example, a payoff demand statement that Countrywide forwarded to Ms. Connor showed accrued interest on her loan totaling $64,105.13. Line items identified only as "fees due" and "additional fees and costs" totaled another $8,525. The statement shows that the total amount due to release the lien Countrywide held on Ms. Connor's property was $520,649 — up from $442,634 when she went into delinquency almost exactly a year earlier.

The debt keeps mounting. By last week, her total amount due was $551,093. Since February 2006, she had accumulated added interest of $88,204 and nebulous "fees" of almost $11,000.

Mr. Bailey of Countrywide described the bulk of the fees as charges for legal work and other foreclosure expenses that are reimbursed to outside vendors. But some of the fees go to Countrywide units that provide title, appraisal and other services.

Still, Countrywide tried to extract other money from Ms. Connor. Last July, a few days before her house was to go on the auction block, she said she asked Countrywide for a delay so that a potential buyer who was willing to pay more than the company was owed could buy the home. The buyer was willing to close on the purchase in two weeks, without a home inspection.

Countrywide agreed to delay the auction for 30 days but only if she wired $5,900 in cash within a few days, Ms. Connor said. Countrywide said that the investor who holds her loan had asked for the payment. Although she refused to make it, Countrywide still delayed the auction.

Countrywide said it would not allow Ms. Connor to sell the home for $550,000 because it would also be forced to pay off a $25,000 home equity loan that Ms. Connor's credit union holds on the property. She said Countrywide told her it would initially pay only $1,000 of the equity loan because its investors do not like to see it paying out money to another financial institution when a foreclosed house is sold.

Countrywide later increased the amount it would offer to the credit union to $3,500. Last week, after a reporter began asking about Ms. Connor's situation, it raised that amount to $5,000.

Mr. Bailey of Countrywide said the problem is persuading the credit union to agree to take less than it is owed. "Jane Connor is frustrated that we are not agreeing to a short sale," he said. "We would love for it to happen."

But Ms. Connor said that navigating the Countrywide maze has been exasperating. Poring over her last three months of phone bills, she identified about 670 calls relating to her home foreclosure, most of them messages left with Countrywide. She said that last July, when she first began asking Countrywide to agree to a sale, she and her lawyer had to speak with 14 different people at the company — and received nine different answers about how best to proceed.

Countrywide says that because its HOPE Team is so large, communications problems will inevitably emerge. "With 2,700 employees, there are times when one of those employees wasn't as responsive as they should have been," Mr. Bailey said. "We have gotten good at managing; we are not at all difficult to contact." He said that in August, Countrywide made 10.5 million attempts to reach delinquent borrowers.

Late last week, Countrywide stepped up its efforts to allow Ms. Connor's sale to go through. Under the terms of the sale, which had not gone through as of Friday, both real estate agents agreed to cut their commissions. Countrywide would get almost all that it is owed.

BRUCE MARKS is founder of the Neighborhood Assistance Corporation of America, a nonprofit advocacy and mortgage company that helps troubled borrowers get new, low-cost loans. He sees problem mortgages from across the country and works with a variety of lenders. He said that his organization has resolved 3,500 cases for imperiled borrowers this year, and that none have had to leave their homes.

Mr. Marks, too, characterizes Countrywide as the lender most unwilling to help borrowers.

"Homeowners who are desperate to keep their homes are trying to restructure the mortgages to the payment before the rates reset," he said. "Countrywide demands their last dollar and their retirement funds to stop a foreclosure on unaffordable loans."

Ms. Rivas-Spivey said she was particularly disturbed that Countrywide's flood insurance error helped push her into trouble. Her woes began when Countrywide took over her loan two years ago. It billed her escrow account to cover the unneeded flood insurance as well as the tax payments that she said she was making separately. She didn't know that she was behind on her mortgage, she said, until Countrywide refused her November payment. By then, she was also in foreclosure.

Reaching anyone at Countrywide to help fix the problem was difficult, she recalled. When she did, she said, the company insisted that insurance was required on her property because of a recent change in the flood insurance rate map for her neighborhood. But Ms. Rivas-Spivey consulted with the Army Corps of Engineers and received a letter from it stating that the map had not changed since 1982.

Finally, in February 2006, Countrywide credited her escrow account for the flood insurance. In March, she received a letter from a Countrywide workout negotiator agreeing to correct her credit report for the months of August 2005 through February 2006. Still, with assorted late fees and owed payments piling up, she could not afford the loan. Neither could she afford the workout plan offered by Countrywide.

Ms. Rivas-Spivey said she and her fiancé cannot pay the current monthly mortgage, which recently rose 20 percent, to $1,875, and is scheduled to rise again soon. Interest owed, late fees and other charges have increased the loan to $196,000 from $141,000 in late 2005.

"I got two workout negotiators from Countrywide and they said 'if you can't afford your house, I can't help you,'" she said. Mr. Bailey called Ms. Rivas-Spivey's account of her dealings with Countrywide "confused." The company corrected the flood insurance problem and put her on a workout program, he said, but she fell off after three months. "It's difficult because she is so far behind," Mr. Bailey said.

Although Ms. Rivas-Spivey and her family remain in their three-bedroom home, they put it on the market last week. "They put all the arrears on top of my payment," she said. "Then it was impossible to pay, and we fell behind."

ZENA COLLINS of Gaithersburg, Md., is yet another Countrywide borrower who, while not in foreclosure, is in financial difficulty. An analyst for the Plumbers and Pipefitters National Pension Fund in Washington, Ms. Collins refinanced into an interest-only loan after she lost a previous job that paid her twice what she earns now. She said her interest rate is 10.9 percent and that after she pays her loan and insurance, she has $600 a month left to live on.

Trying to act before foreclosure looms on her home, she has asked Countrywide to modify the terms of her loan. The company has refused. In a notice dated Sept. 20, Countrywide gave Ms. Collins this reason for being ineligible for help: "Borrower does not qualify."

"I would like for the people who make these decisions to be put in the same position that I was, having to choose not to have electricity from time to time because I didn't have any other option, really," Ms. Collins said. "It makes one feel very desperate and hopeless."

The national foreclosure wave, meanwhile, may soon become a tsunami. Some $120 billion in adjustable-rate mortgages are scheduled to reset at higher interest rates in the next three months. Subprime, adjustable-rate loans make up about $90 billion of that.

In a recent interview, a Countrywide mortgage specialist on the West Coast said he was disturbed by the sight of customers streaming into his branch asking for help on loans they could not afford. The employee, who was granted anonymity because he feared that Countrywide might retaliate against him, said it took a full day for him to reach the right department at Countrywide for loan workouts. Even he had difficulty reaching the right HOPE Team member, he said.

Such efforts may soon become more difficult. At an investor conference on Sept. 18, Angelo R. Mozilo, Countrywide's chief executive, said the company would be hiring more staff members to do home-retention and loss-mitigation work. Those employees, however, will be based in India.

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November 6, 2007

Dubious Fees Hit Borrowers in Foreclosures

By GRETCHEN MORGENSON

As record numbers of homeowners default on their mortgages, questionable practices among lenders are coming to light in bankruptcy courts, leading some legal specialists to contend that companies instigating foreclosures may be taking advantage of imperiled borrowers.

Because there is little oversight of foreclosure practices and the fees that are charged, bankruptcy specialists fear that some consumers may be losing their homes unnecessarily or that mortgage servicers, who collect loan payments, are profiting from foreclosures.

Bankruptcy specialists say lenders and loan servicers often do not comply with even the most basic legal requirements, like correctly computing the amount a borrower owes on a foreclosed loan or providing proof of holding the mortgage note in question.

"Regulators need to look beyond their current, myopic focus on loan origination and consider how servicers' calculation and collection practices leave families vulnerable to foreclosure," said Katherine M. Porter, associate professor of law at the University of Iowa.

In an analysis of foreclosures in Chapter 13 bankruptcy, the program intended to help troubled borrowers save their homes, Ms. Porter found that questionable fees had been added to almost half of the loans she examined, and many of the charges were identified only vaguely. Most of the fees were less than $200 each, but collectively they could raise millions of dollars for loan servicers at a time when the other side of the business, mortgage origination, has faltered.

In one example, Ms. Porter found that a lender had filed a claim stating that the borrower owed more than $1 million. But after the loan history was scrutinized, the balance turned out to be $60,000. And a judge in Louisiana is considering an award for sanctions against Wells Fargo in a case in which the bank assessed improper fees and charges that added more than $24,000 to a borrower's loan.

Ms. Porter's analysis comes as more homeowners face foreclosure. Testifying before Congress on Tuesday, Mark Zandi, the chief economist at Moody's Economy.com, estimated that two million families would lose their homes by the end of the current mortgage crisis.

Questionable practices by loan servicers appear to be enough of a problem that the Office of the United States Trustee, a division of the Justice Department that monitors the bankruptcy system, is getting involved. Last month, It announced plans to move against mortgage servicing companies that file false or inaccurate claims, assess unreasonable fees or fail to account properly for loan payments after a bankruptcy has been discharged.

On Oct. 9, the Chapter 13 trustee in Pittsburgh asked the court to sanction Countrywide, the nation's largest loan servicer, saying that the company had lost or destroyed more than $500,000 in checks paid by homeowners in foreclosure from December 2005 to April 2007.

The trustee, Ronda J. Winnecour, said in court filings that she was concerned that even as Countrywide misplaced or destroyed the checks, it levied charges on the borrowers, including late fees and legal costs.

"The integrity of the bankruptcy process is threatened when a single creditor dishonors its obligation to provide a truthful and accurate account of the funds it has received," Ms. Winnecour said in requesting sanctions.

A Countrywide spokesman disputed the accusations about the lost checks, saying the company had no record of having received the payments the trustee said had been sent. It is Countrywide's practice not to charge late fees to borrowers in bankruptcy, he said, adding that the company also does not charge fees or costs relating to its own mistakes.

Loan servicing is extremely lucrative. Servicers, which collect payments from borrowers and pass them on to investors who own the loans, generally receive a percentage of income from a loan, often 0.25 percent on a prime mortgage and 0.50 percent on a subprime loan. Servicers typically generate profit margins of about 20 percent.

Now that big lenders are originating fewer mortgages, servicing revenues make up a greater percentage of earnings. Because servicers typically keep late fees and certain other charges assessed on delinquent or defaulted loans, "a borrower's default can present a servicer with an opportunity for additional profit," Ms. Porter said.

The amounts can be significant. Late fees accounted for 11.5 percent of servicing revenues in 2006 at Ocwen Financial, a big servicing company. At Countrywide, $285 million came from late fees last year, up 20 percent from 2005. Late fees accounted for 7.5 percent of Countrywide's servicing revenue last year.

But these are not the only charges borrowers face. Others include $145 in something called "demand fees," $137 in overnight delivery fees, fax fees of $50 and payoff statement charges of $60. Property inspection fees can be levied every month or so, and fees can be imposed every two months to cover assessments of a home's worth.

"We're talking about millions and millions of dollars that mortgage servicers are extracting from debtors that I think are totally unlawful and illegal," said O. Max Gardner III, a lawyer in Shelby, N.C., specializing in consumer bankruptcies. "Somebody files a Chapter 13 bankruptcy, they make all their payments, get their discharge and then three months later, they get a statement from their servicer for $7,000 in fees and charges incurred in bankruptcy but that were never applied for in court and never approved."

Some fees levied by loan servicers in foreclosure run afoul of state laws. In 2003, for example, a New York appeals court disallowed a $100 payoff statement fee sought by North Fork Bank.

Fees for legal services in foreclosure are also under scrutiny.

A class-action lawsuit filed in September in Federal District Court in Delaware accused the Mortgage Electronic Registration System, a home loan registration system owned by Fannie Mae, Countrywide

Financial and other large lenders, of overcharging borrowers for legal services in foreclosures. The system, known as MERS, oversees more than 20 million mortgage loans.

The complaint was filed on behalf of Jose Trevino and Lorry S. Trevino of University City, Mo., whose Washington Mutual loan went into foreclosure in 2006 after the couple became ill and fell behind on payments.

Jeffrey M. Norton, a lawyer who represents the Trevinos, said that although MERS pays a flat rate of $400 or $500 to its lawyers during a foreclosure, the legal fees that it demands from borrowers are three or four times that.

A spokeswoman for MERS declined to comment.

Typically, consumers who are behind on their mortgages but hoping to stay in their homes invoke Chapter 13 bankruptcy because it puts creditors on hold, giving borrowers time to put together a repayment plan.

Given that a Chapter 13 bankruptcy involves the oversight of a court, the findings in Ms. Porter's study are especially troubling. In July, she presented her paper to the United States trustee, and on Oct. 12 she outlined her data for the National Conference of Bankruptcy Judges in Orlando, Fla.

With Tara Twomey, who is a lecturer at Stanford Law School and a consultant for the National Association of Consumer Bankruptcy Attorneys, Ms. Porter analyzed 1,733 Chapter 13 filings made in April 2006. The data were drawn from public court records and include schedules filed under penalty of perjury by borrowers listing debts, assets and income.

Though bankruptcy laws require documentation that a creditor has a claim on the property, 4 out of 10 claims in Ms. Porter's study did not attach such a promissory note. And one in six claims was not supported by the itemization of charges required by law.

Without proper documentation, families must choose between the costs of filing an objection or the risk of overpayment, Ms. Porter concluded.

She also found that some creditors ask for fees, like fax charges and payoff statement fees, that would probably be considered "unreasonable" by the courts.

Not surprisingly, these fees may contribute to the other problem identified by her study: a discrepancy between what debtors think they owe and what creditors say they are owed.

In 96 percent of the claims Ms. Porter studied, the borrower and the lender disagreed on the amount of the mortgage debt. In about a quarter of the cases, borrowers thought they owed more than the creditors claimed, but in about 70 percent, the creditors asserted that the debt owed was greater than the amounts specified by borrowers.

The median difference between the amounts the creditor and the borrower submitted was $1,366; the average was $3,533, Ms. Porter said. In 30 percent of the cases in which creditors' claims were higher, the discrepancy was greater than 5 percent of the homeowners' figure.

Based on the study, mortgage creditors in the 1,733 cases put in claims for almost $6 million more than the loan debts listed by borrowers in the bankruptcy filings. The discrepancies are too big, Ms. Porter said, to be simple record-keeping errors.

Michael L. Jones, a homeowner going through a Chapter 13 bankruptcy in Louisiana, experienced such a discrepancy with Wells Fargo Home Mortgage. After being told that he owed $231,463.97 on his mortgage, he disputed the amount and ultimately sued Wells Fargo.

In April, Elizabeth W. Magner, a federal bankruptcy judge in Louisiana, ruled that Wells Fargo overcharged Mr. Jones by $24,450.65, or 12 percent more than what the court said he actually owed. The court attributed some of that to arithmetic errors but found that Wells Fargo had improperly added charges, including $6,741.67 in commissions to the sheriff's office that were not owed, almost $13,000 in additional interest and fees for 16 unnecessary inspections of the borrowers' property in the 29 months the case was pending.

"Incredibly, Wells Fargo also argues that it was debtor's burden to verify that its accounting was correct," the judge wrote, "even though Wells Fargo failed to disclose the details of that accounting until it was sued."

A Wells Fargo spokesman, Kevin Waetke, said the bank would not comment on the details of the case as the bank is appealing a motion by Mr. Jones for sanctions. "All of our practices and procedures in the handling of bankruptcy cases follow applicable laws, and we stand behind our actions in this case," he said.

In Texas, a United States trustee has asked for sanctions against Barrett Burke Wilson Castle Daffin & Frappier, a Houston law firm that sues borrowers on behalf of the lenders, for providing inaccurate information to the court about mortgage payments made by homeowners who sought refuge in Chapter 13.

Michael C. Barrett, a partner at the firm, said he did not expect the firm to be sanctioned.

"We certainly believe we have not misbehaved in any way," he said, saying the trustee's office became involved because it is trying to persuade Congress to increase its budget. "It is trying to portray itself as an organ to pursue mortgage bankers."

Closing arguments in the case are scheduled for Dec. 12.

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FAIR GAME

Blame the Borrowers? Not So Fast

By GRETCHEN MORGENSON

IT has become fashionable of late to say that America's subprime borrowers themselves deserve a good part of the blame for the current mortgage mess. They were either greedy (looking for easy money in a bubbly real estate market) or irresponsible (assuming a debt whose terms they did not understand).

They should be punished for their behavior, the argument goes — not rewarded with loan workouts.

According to this analysis, while subprime lenders may not be blameless, they actually should be lauded for introducing the joys of homeownership to those who had not yet achieved that part of the American dream. Never mind that many lenders peddled the most abusive and costly loans to unsophisticated, first-time home buyers. Known as "affordability products," the mortgages generated big commissions up front and were designed to require refinancing later on — which included yet another round of luscious fees for lenders.

With refinancing no longer an option, it is becoming obvious that these loans were designed to fail. True to their design, they are. And those who thought they might get a chance at owning a home are headed back to the rent rolls.

Figures from the Federal Reserve Board show that the share of subprime mortgages in default is more than 14 percent. And researchers at the Center for Responsible Lending say that 64 percent of foreclosures filed during the 12 months ended June 30 involved subprime loans. A September report from Banc of America Securities said that 93 percent of completed foreclosures this year involved adjustable-rate loans that were made in 2006, pooled and sold to investors.

Regulators have recently stepped up their calls for lenders to be more aggressive in working out these loans. But lenders are pushing back, and borrower advocates — those nearest to the problem — say that not much is getting done.

AS this workout war simmers, it seems worthwhile to consider both sides of this mess.

Should greedy subprime borrowers take responsibility or should greedy subprime lenders get tagged? Nothing is ever black and white, of course. Undoubtedly, there are plenty of cases in which both borrower and lender are at fault, and others in which just one of the parties may bear greater blame.

Still, it's also important to examine some of our long-held assumptions about the sophistication and responsibility of low-income borrowers when trying to make sense of this debate. After all, nonprime borrowers in low-cost, fixed-rate mortgages — appropriate loans for low-income, first-time homeowners — can succeed. And there are figures to prove it.

They come from NeighborWorks America, a nonprofit organization created in 1978 by Congress to deliver financial aid and training to troubled urban communities. Its affiliate, the Neighborhood Housing Services of America, makes loans to home buyers of low and moderate incomes, a group that resembles the typical subprime borrower. And it's revealing to compare the delinquency and foreclosure rates for subprime loans made by traditional lenders with mortgages made by the Neighborhood Housing Services fund.

The fund contains almost 3,000 loans totaling $205 million as of June 30. Its borrowers do not meet conventional credit standards, and their incomes average less than two-thirds the national median income. Some 93 percent of those receiving loans from the fund are first-time home buyers, and almost 90 percent are low- or moderate-income borrowers. Approximately 54 percent are minority households.

And yet, the NeighborWorks borrowers aren't experiencing the same mortgage woes as subprime borrowers elsewhere around the country. Why?

As of June 30, the most recent figures available, 3.34 percent of NeighborWorks' borrowers were at least 30 days' delinquent on their loans, only slightly higher than the 2.63 percent delinquency rate on prime loans recorded in that period by the Mortgage Bankers Association.

Compared with subprime loans over all, the NeighborWorks loans really outperform. Its 3.34 percent delinquency rate is well below the 14.54 percent on subprime loans nationwide.

Foreclosure figures show a similar pattern. The NeighborWorks loans that went into foreclosure during the second quarter of 2007 totaled 0.56 percent, while subprime loan foreclosures came in at 2.45 percent during that period. The foreclosure rate for NeighborWorks loans was a little over double the 0.25 percent rate for prime loans in the period.

"Our loans performed many times better than subprime," said Kenneth D. Wade, chief executive of NeighborWorks. "It shows that you can serve this customer base and they can succeed."

Some of the success of these loans may be a result of an extensive mortgage education program conducted by the 130 loan counselors of NeighborWorks before and after a loan is made.

But surely the biggest reason that the NeighborWorks loans outperform is that they were not the so-called affordability mortgages, with adjustable interest rates that skyrocket after several years or those that allow borrowers to pay none of their principal for an extended period. Those are the loans that are failing all around us.

For example, according to data presented to an Office of Thrift Supervision forum last December, around 90 percent of subprime loans originated between 2004 and 2006 carried exploding adjustable rates. Some 70 percent of subprime loans have prepayment penalties, versus 2 percent of prime loans. The Center for Responsible Lending estimates that 52 percent of home purchase loans made to African-American families were subprime, and that 41 percent of loans to Latino borrowers were subprime.

And what of the real estate speculators whom many lenders like to blame for the subprime problem? Banc of America Securities estimated in a report in late September that just 7 percent of foreclosures involving adjustable-rate loans were made to such borrowers. The report also noted that the difference in delinquency rates between speculators and resident borrowers was 0.1 percentage point.

The NeighborWorks counselors are now advising borrowers trapped in problem loans made by other institutions. Mr. Wade said that in the third quarter of this year, his organization logged 57,000 calls, up 90 percent from the second quarter. One in five callers, he said, had income of $42,000 to $60,000 a year while 13 percent made more than $60,000 a year.

Robert L. Gnaizda, policy director and general counsel of the Greenlining Institute, an advocacy organization in Berkeley, Calif., says he believes that lenders, not borrowers, should shoulder the blame for this debacle.

"Lenders were like the worst stockbrokers peddling stocks in 1999 saying there is a new dynamic now," he said. "We believe financial institutions have a fiduciary responsibility. They shouldn't be promoting instruments that are high-risk and they know it."

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nytimes.com

January 8, 2008

Lender Tells Judge It 'Recreated' Letters

By GRETCHEN MORGENSON

The Countrywide Financial Corporation fabricated documents related to the bankruptcy case of a Pennsylvania homeowner, court records show, raising new questions about the business practices of the giant mortgage lender at the center of the subprime mess.

The documents — three letters from Countrywide addressed to the homeowner — claimed that the borrower owed the company $4,700 because of discrepancies in escrow deductions. Countrywide's local counsel described the letters to the court as "recreated," raising concern from the federal bankruptcy judge overseeing the case, Thomas P. Agresti.

"These letters are a smoking gun that something is not right in Denmark," Judge Agresti said in a Dec. 20 hearing in Pittsburgh.

The emergence of the fabricated documents comes as Countrywide confronts a rising tide of complaints from borrowers who claim that the company pushed them into risky loans. The matter in Pittsburgh is one of 300 bankruptcy cases in which Countrywide's practices have come under scrutiny in western Pennsylvania.

Judge Agresti said that discovery should proceed so that those involved in the case, including the Chapter 13 trustee for the western district of Pennsylvania and the United States trustee, could determine how Countrywide's systems might generate such documents.

A spokesman for the lender, Rick Simon, said: "It is not Countrywide's policy to create or 'fabricate' any documents as evidence that they were sent if they had not been. We believe it will be shown in further discovery that the Countrywide bankruptcy technician who generated the documents at issue did so as an efficient way to convey the dates the escrow analyses were done and the calculations of the payments as a result of the analyses."

The documents were generated in a case involving Sharon Diane Hill, a homeowner in Monroeville, Pa. Ms. Hill filed for Chapter 13 bankruptcy protection in March 2001 to try to save her home from foreclosure.

After meeting her mortgage obligations under the 60-month bankruptcy plan, Ms. Hill's case was discharged and officially closed on March 9, 2007. Countrywide, the servicer on her loan, did not object to the discharge; court records from that date show she was current on her mortgage.

But one month later, Ms. Hill received a notice of intention to foreclose from Countrywide, stating that she was in default and owed the company $4,166.

Court records show that the amount claimed by Countrywide was from the period during which Ms. Hill was making regular payments under the auspices of the bankruptcy court. They included "monthly charges" totaling $3,840 from November 2006 to April 2007, late charges of $128 and other charges of almost $200.

A lawyer representing Ms. Hill in her bankruptcy case, Kenneth Steidl, of Steidl and Steinberg in Pittsburgh, wrote Countrywide a few weeks later stating that Ms. Hill had been deemed current on her mortgage during the period in question. But in May, Countrywide sent Ms. Hill another notice stating that her loan was delinquent and demanding that she pay $4,715.58. Neither Mr. Steidl nor Julia Steidl, who has also represented Ms. Hill, returned phone calls seeking comment.

Justifying Ms. Hill's arrears, Countrywide sent her lawyer copies of three letters on company letterhead addressed to the homeowner, as well as to Mr. Steidl and Ronda J. Winnecour, the Chapter 13 trustee for the western district of Pennsylvania.

The Countrywide letters were dated September 2003, October 2004 and March 2007 and showed changes in escrow requirements on Ms. Hill's loan. "This letter is to advise you that the escrow requirement has changed per the escrow analysis completed today," each letter began.

But Mr. Steidl told the court he had never received the letters. Furthermore, he noticed that his address on the first Countrywide letter was not the location of his office at the time, but an address he moved to later. Neither did the Chapter 13 trustee's office have any record of receiving the letters, court records show.

When Mr. Steidl discussed this with Leslie E. Puida, Countrywide's outside counsel on the case, he said Ms. Puida told him that the letters had been "recreated" by Countrywide to reflect the escrow discrepancies, the court transcript shows. During these discussions, Ms. Puida reduced the amount that Countrywide claimed Ms. Hill owed to $1,500 from $4,700.

Under questioning by the judge, Ms. Puida said that "a processor" at Countrywide had generated the letters to show how the escrow discrepancies arose. "They were not offered to prove that they had been sent," Ms. Puida said. But she also said, under questioning from the court, that the letters did not carry a disclaimer indicating that they were not actual correspondence or that they had never been sent.

A Countrywide spokesman said that in bankruptcy cases, Countrywide's automated systems are sometimes overridden, with technicians making manual adjustments "to comply with bankruptcy laws and the requirements in the jurisdiction in which a bankruptcy is pending." Asked by Judge Agresti why Countrywide would go to the trouble of "creating a letter that was never sent," Ms. Puida, its lawyer, said she did not know.

"I just, I can't get over what I'm being told here about these recreations," Judge Agresti said, "and what the purpose is or was and what was intended by them."

Ms. Hill's matter is one of 300 bankruptcy cases involving Countrywide that have come under scrutiny by Ms. Winnecour, the Chapter 13 trustee in Pittsburgh. On Oct. 9, she asked the court to sanction Countrywide, contending that the company had lost or destroyed more than $500,000 in checks paid by homeowners in bankruptcy from December 2005 to April 2007.

Ms. Winnecour said in court filings that she was concerned that even as Countrywide had misplaced or destroyed the checks, it levied charges on the borrowers, including late fees and legal costs. A spokesman in her office said she would not comment on the Hill case.

O. Max Gardner III, a lawyer in North Carolina who represents troubled borrowers, says that he routinely sees lenders pursue borrowers for additional money after their bankruptcies have been discharged and the courts have determined that the default has been cured and borrowers are current. Regarding the Hill matter, Mr. Gardner said: "The real problem in my mind when reading the transcript is that Countrywide's lawyer could not explain how this happened."

March 30, 2008

Foreclosure Machine Thrives on Woes

By GRETCHEN MORGENSON and JONATHAN D. GLATER

NOBODY wins when a home enters foreclosure – neither the borrower, who is evicted, nor the lender, who takes a loss when the home is resold. That's the conventional wisdom, anyway.

The reality is very different. Behind the scenes in these dramas, a small army of law firms and default servicing companies, who represent mortgage lenders, have been raking in mounting profits. These little-known firms assess legal fees and a host of other charges, calculate what the borrowers owe and draw up the documents required to remove them from their homes.

As the subprime mortgage crisis has spread, the volume of the business has soared, and firms that handle loan defaults have been the primary beneficiaries. Law firms, paid by the number of motions filed in foreclosure cases, have sometimes issued a flurry of claims without regard for the requirements of bankruptcy law, several judges say.

Much as Wall Street's mortgage securitization machinery helped to fuel questionable lending across the United States, default, or foreclosure, servicing operations have been compounding the woes of troubled borrowers. Court documents say that some of the largest firms in the industry have repeatedly submitted erroneous affidavits when moving to seize homes and levied improper fees that make it harder for homeowners to get back on track with payments. Consumer lawyers call these operations "foreclosure mills."

"They get paid by the volume and speed with which they process these foreclosures," said Mal Maynard, director of the Financial Protection Law Center, a nonprofit firm in Wilmington, N.C.

John and Robin Atchley of Waleska, Ga., have experienced dubious foreclosure practices at first hand. Twice during a four-month period in 2006, the Atchleys were almost forced from their home when Countrywide Home Loans, part of Countrywide Financial, and the law firm representing it said they were delinquent on their mortgage. Countrywide's lawyers withdrew their motions to seize the Atchleys' home only after the couple proved them wrong in court.

The possibility that some lenders and their representatives are running roughshod over borrowers is of increasing concern to bankruptcy judges overseeing Chapter 13 cases across the country. The United States Trustee Program, a unit of the Justice Department that oversees the integrity of the nation's bankruptcy courts, is bringing cases against lenders that it says are abusing the bankruptcy system.

Joel B. Rosenthal, a United States bankruptcy judge in the Western District of Massachusetts, wrote in a case last year involving Wells Fargo Bank that rising foreclosures were resulting in greater numbers of lenders that "in their rush to foreclose, haphazardly fail to comply with even the most basic legal requirements of the bankruptcy system."

Law firms and default servicing operations that process large numbers of cases have made it harder for borrowers to design repayment plans, or workouts, consumer lawyers say. "As I talk to people around the country, they all unanimously state that the foreclosure mills are impediments to loan workouts," Mr. Maynard said.

LAST month, almost 225,000 properties in the United States were in some stage of foreclosure, up nearly 60 percent from the period a year earlier, according to RealtyTrac, an online foreclosure research firm and marketplace.

These proceedings generate considerable revenue for the firms involved: eviction and appraisal charges, late fees, title search costs, recording fees, certified mailing costs, document retrieval fees, and legal fees. The borrower, already in financial distress, is billed for these often burdensome costs. While much of the revenue goes to the law firms hired by lenders, some is kept by the servicers of the loans.

Fidelity National Default Solutions, a unit of Fidelity National Information Services of Jacksonville, Fla., is one of the biggest foreclosure service companies. It assists 19 of the top 25 residential mortgage servicers and 14 of the top 25 subprime loan servicers.

Citing "accelerating demand" for foreclosure services last year, Fidelity generated operating income of $443 million in its lender processing unit, a 13.3 percent increase over 2006. By contrast, the increase from 2005 to 2006 was just 1 percent. The firm is not associated with Fidelity Investments.

Law firms representing lenders are also big beneficiaries of the foreclosure surge. These include Barrett Burke Wilson Castle Daffin & Frappier, a 38-lawyer firm in Houston; McCalla, Raymer, Padrick, Cobb, Nichols & Clark, a 37-member firm in Atlanta that is a designated counsel to Fannie Mae; and the Shapiro Attorneys Network, a nationwide group of 24 firms.

While these private firms do not disclose their revenues, Wesley W. Steen, chief bankruptcy judge for the Southern District of Texas, recently estimated that Barrett Burke generated between $9.7 million and $11.6 million a year in its practice. Another judge estimated last year that the firm generated $125,000 every two weeks — or $3.3 million a year — filing motions that start the process of seizing borrowers' homes.

Court records from 2007 indicate that McCalla, Raymer generated $10.4 million a year on its work for Countrywide alone. In 2005, some McCalla, Raymer employees left the firm and created MR Default Services, an entity that provides foreclosure services; it is now called Prommis Solutions.

For years, consumer lawyers say, bankruptcy courts routinely approved these firms' claims and fees. Now, as the foreclosure tsunami threatens millions of families, the firms' practices are coming under scrutiny.

And none too soon, consumer lawyers say, because most foreclosures are uncontested by borrowers, who generally rely on what the lender or its representative says is owed, including hefty fees assessed during the foreclosure process. In Georgia, for example, a borrower can watch his home go up for auction on the courthouse steps after just 40 days in foreclosure, leaving relatively little chance to question fees that his lender has levied.

A recent analysis of 1,733 foreclosures across the country by Katherine M. Porter, associate professor of law at the University of Iowa, showed that questionable fees were added to borrowers' bills in almost half the loans.

Specific cases inching through the courts support the notion that figures supplied by lenders are often incorrect. Lawyers representing clients who have filed for Chapter 13 bankruptcy, the program intended to help them keep their homes, say it is especially distressing when these numbers are used to evict borrowers.

"If the debtor wants accurate information in a bankruptcy case on her mortgage, she has got to work hard to find that out," said Howard D. Rothbloom, a lawyer in Marietta, Ga., who represents borrowers. That work, usually done by a lawyer, is costly.

Mr. Rothbloom represents the Atchleys, who almost lost their home in early 2006 when legal representatives of their loan servicer, Countrywide, incorrectly told the court that the Atchleys were 60 days delinquent in Chapter 13 plan payments two times over four months. Borrowers can lose their homes if they fail to make such payments.

After the Atchleys supplied proof that they had made their payments on both occasions, Countrywide withdrew its motions to begin foreclosure. But the company also levied $2,793 in fees on the Atchleys' loan that it did not explain, court documents said. "Every paycheck went to what they said we owed," Robin Atchley said. "And every statement we got, the payoff was $179,000 and it never went down. I really think they took advantage of us."

The Atchleys, who have four children, sold the house and now rent. Mrs. Atchley said they lost more than $23,000 in equity in the home because of fees levied by Countrywide.

The United States Trustee sued Countrywide last month in the Atchley case, saying its pattern of conduct was an abuse of the bankruptcy system. Countrywide said that it could not comment on pending litigation and that privacy concerns prevented it from discussing specific borrowers.

A generation ago, home foreclosures were a local business, lawyers say. If a borrower got into trouble, the lender who made the loan was often a nearby bank that held on to the mortgage. That bank would hire a local lawyer to try to work with the borrower; foreclosure proceedings were a last resort.

Now foreclosures are farmed out to third-party processors who hire local counsel to litigate. Lenders negotiate flat-fee arrangements to try to keep legal bills down.

AN unfortunate result, according to several judges, is a drive to increase revenue by filing more motions. Jeff Bohm, a bankruptcy judge in Texas who oversaw a case between William Allen Parsley, a borrower in Willis, Tex., and legal representatives for Countrywide, said the flat-fee structure "has fostered a corrosive 'assembly line' culture of practicing law." Both McCalla, Raymer and Barrett Burke represented Countrywide in the matter.

Gee Aldridge, managing partner at McCalla, Raymer, called the Parsley case unique. "It is the goal of every single one of my clients to do whatever they can do to keep borrowers in their homes," he said. Officials at Barrett Burke did not return phone calls seeking comment.

In a statement, Countrywide said it recognized the importance of the efficient functioning of the bankruptcy system. It said that servicing loans for borrowers in bankruptcy was complex, but that it had improved its procedures, hired new employees and was "aggressively exploring additional technology solutions to ensure that we are servicing loans in a manner consistent with applicable guidelines and policies."

The September 2006 issue of The Summit, an in-house promotional publication of Fidelity National Foreclosure Solutions, another unit of Fidelity, trumpeted the efficiency of its 18-member "document execution team." Set up "like a production line," the publication said, the team executes 1,000 documents a day, on average.

OTHER judges are cracking down on some foreclosure practices. In 2006, Morris Stern, the federal bankruptcy judge overseeing a matter involving Jenny Rivera, a borrower in Lodi, N.J., issued a $125,000 sanction against the Shapiro & Diaz firm, which is a part of the Shapiro Attorneys Network. The judge found that Shapiro & Diaz had filed 250 motions seeking permission to seize homes using pre-signed certifications of default executed by an employee who had not worked at the firm for more than a year.

In testimony before the judge, a Shapiro & Diaz employee said that the firm used the pre-signed documents beginning in 2000 and that they were attached to "95 percent" of the firm's motions seeking permission to seize a borrower's home. Individuals making such filings are supposed to attest to their accuracy. Judge Stern called Shapiro & Diaz's use of these documents "the blithe implementation of a renegade practice."

Nelson Diaz, a partner at the firm, did not return a phone call seeking comment.

Butler & Hosch, a law firm in Orlando, Fla., that is employed by Fannie Mae, has also been the subject of penalties. Last year, a judge sanctioned the firm $33,500 for filing 67 faulty motions to remove borrowers from their homes. A spokesman for the firm declined to comment.

Barrett Burke in Texas has come under intense scrutiny by bankruptcy judges. Overseeing a case last year involving James Patrick Allen, a homeowner in Victoria, Tex., Judge Steen examined the firm's conduct in eight other foreclosure cases and found problems in all of them. In five of the matters, documents show, the firm used inaccurate information about defaults or failed to attach proper documentation when it moved to seize borrowers' homes. Judge Steen imposed $75,000 in sanctions against Barrett Burke for a pattern of errors in the Allen case.

A former Barrett Burke lawyer, who requested anonymity to avoid possible retaliation from the firm, said, "They're trying to find a fine line between providing efficient, less costly service to the mortgage companies" and not harming the borrower.

Both he and another former lawyer at the firm said Barrett Burke relied heavily on paralegals and other nonlawyer employees in its foreclosure and bankruptcy practices. For example, they said, paralegals prepared documents to be filed in bankruptcy court, demanding that the court authorize foreclosure on a borrower's home. Lawyers were supposed to review the documents before they were filed. Both former Barrett lawyers said that with at least 1,000 filings a month, it was hard to keep up with the volume.

This factory-line approach to litigation was one reason he decided to leave the firm, the first lawyer said. "I had questions," he added, "about whether doing things efficiently was worth whatever the cost was to the consumer."

James R. and Tracy A. Edwards, who are now living in New Mexico, say they have had problems with questionable fees charged by Countrywide and actions by Barrett Burke. In one month in 2002, when the couple lived in Houston, Countrywide Home Loans withdrew three monthly mortgage payments from their bank account, Mrs. Edwards said, leaving them unable to pay other bills. The family filed for bankruptcy to try to keep their home, cars and other assets.

Filings in the bankruptcy case of the Edwards family show that on at least three occasions, Countrywide's lawyers at Barrett Burke filed motions contending that the borrowers had fallen behind. The firm subsequently withdrew the motions.

"They kept saying we owed tons and tons of fees on the house," Mrs. Edwards said. Tired of this battle, the family gave up the Houston house and moved to one in Rio Rancho, N.M., that they had previously rented out.

Countrywide tried to foreclose on that house, too, contending that Mr. and Mrs. Edwards were behind in their payments. Again, Mrs. Edwards said, the culprit was a raft of fees that Countrywide had never told them about — and that were related to their Texas home. Mrs. Edwards says that she and her husband plan to sue Countrywide to block foreclosure on their New Mexico home.

Pamela L. Stewart, president of the Houston Association of Debtor Attorneys, said she has become skeptical of lenders' claims of fees owed. "I want to see documents that back up where these numbers are coming from," Ms. Stewart said. "To me, they're pulled out of the air."

An inaccurate mortgage payment history supplied by Ameriquest, a mortgage lender that is now defunct, was central to a case last year in federal bankruptcy court in Massachusetts. "Ameriquest is simply unable or unwilling to conform its accounting practices to what is required under the bankruptcy code," Judge Rosenthal wrote. He awarded the borrower $250,000 in emotional-distress damages and $500,000 in punitive damages.

Fidelity National Information Services has also been sued. A complaint filed on behalf of Ernest and Mattie Harris in federal bankruptcy court in Houston contends that Fidelity receives kickbacks from the lawyers it works with on foreclosure matters.

The case shines some light on the complex relationships between lenders and default servicers and the law firms that represent them. The Harrises' loan servicer is Saxon Mortgage Services, a Morgan Stanley unit, which signed an agreement with Fidelity National Foreclosure Solutions. Under it, Fidelity was to provide foreclosure and bankruptcy services on loans serviced by Saxon, as well as to manage lawyers acting on Saxon's behalf. The agreement also specified that Saxon would pay the fees of the lawyers managed by Fidelity.

But Fidelity also struck a second agreement, with an outside law firm, Mann & Stevens in Houston, which spelled out the fees Fidelity was to be paid each time the law firm made filings in a case. Mann & Stevens, which did respond to phone calls, represented Saxon in the Harrises' bankruptcy proceedings.

According to the complaint, Mann & Stevens billed Saxon $200 for filing an objection to the borrowers' plan to emerge from bankruptcy. Saxon paid the $200 fee, then charged that amount to the Harrises, according to the complaint. But Mann & Stevens kept only $150, paying the remaining $50 to Fidelity, the complaint said.

This arrangement constitutes improper fee-sharing, the Harrises argued. Texas rules of professional conduct bar fee-sharing between lawyers and nonlawyers because that could motivate them to raise prices — and the Harrises argue that this is why the law firm charged $200 instead of $150. And under these rules, sharing fees with someone who is not a lawyer creates a risk that the financial relationship could affect the judgment of the lawyer, whose duty is to the client. Few exceptions are permitted — like sharing court-awarded fees with a nonprofit organization or keeping a retirement plan for nonlawyer employees of a law firm.

"If it's fee-sharing, and if it doesn't fall into those categories, it sounds wrong," said Michael S. Frisch, adjunct professor of law at Georgetown University. Greg Whitworth, president of loan portfolio solutions at Fidelity, defended the arrangement, saying it was not unusual for a company to have an intermediary manage outside law firms on its behalf.

The Harrises contend that the bankruptcy-related fees charged by the law firms managed by Fidelity "are inflated by 25 to 50 percent." The agreement between Fidelity and the law firm is also hidden, according to their complaint, so a presiding judge sees only the lender and the law firm, not the middleman.

Fidelity said the money it received from the law firm was not a kickback, but payments for services, just as a law firm would pay a copying service to duplicate documents. In response to the complaint, Fidelity asserted in a court filing that the Harrises' claims were "nothing more than scandalous, hollow rhetoric."

But the Fidelity fee schedule shows a charge for each action taken by the law firm, not a fee per page or kilobyte. And Fidelity's contract appears to indemnify Saxon if the arrangement between Fidelity and its law firm runs afoul of conduct rules.

Mr. Whitworth of Fidelity said that the arrangement with Mann & Stevens did not constitute fee sharing, because Fidelity was to be paid by that law firm even if the law firm itself was not paid.

He also said that by helping a servicer manage dozens or even hundreds of law firms, Fidelity lowered the cost of foreclosure or bankruptcy proceedings, to the benefit of the law firm, the servicer and the borrower. "Both parties want us to be in the middle here," Mr. Whitworth said, referring to law firms and mortgage servicing companies.

THE Fidelity contract attached to the complaint also hints at the money each motion generates. Foreclosures earn lawyers fees of $500 or more under the contract; evictions generate about $300. Those fees aren't enormous if they require a substantial amount of time. But a few thousand such motions a month, executed by lawyers' employees, translates into many hundreds of thousands of dollars in revenue to the law firm — and the lower the firm's costs, the greater the profits.

"Congress needs to enact a national foreclosure bill that sets a uniform procedure in every state that provides adequate notice, due process and transparency about fees and charges," said O. Max Gardner III, a consumer lawyer in Shelby, N.C. "A lot of this stuff is such a maze of numbers and complex organizational structure most lawyers can't get through it. For the average consumer, it is mission impossible."

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FAIR GAME

Piling On: Borrowers Buried by Fees

By GRETCHEN MORGENSON

SLOWLY but surely, a handful of public-minded bankruptcy court judges are drawing back the curtain on the mortgage servicing business, exposing, among other questionable practices, the sundry and onerous fees that big banks and financial companies levy on troubled borrowers.

It isn't a pretty sight, if you are a borrower. But shining a light on this dark corner certainly qualifies as progress.

The cases come out of bankruptcy courts in Delaware, Louisiana and New York, and each one shows how improper, undisclosed or questionable fees unfairly penalize borrowers already struggling with mortgage debt or bankruptcy.

Given the number of new borrowers falling daily into the foreclosure mire, dubious practices by servicers are beyond troubling. Foreclosure filings rose 57 percent in March over the same period in 2007, according to RealtyTrac, the real estate and foreclosure Web site. It also said that banks repossessed more than 50,000 homes last month, more than twice the amount of one year earlier.

If even one of those repossessions was owing to improper fees or practices, that would be one too many.

The case out of the Eastern District of Louisiana, overseen by Judge Elizabeth W. Magner, is especially depressing. It involves Dorothy Chase Stewart, an elderly borrower and widow whose original loan of $61,200 was serviced by Wells Fargo. Judge Magner cited "abusive imposition of unwarranted fees and charges," and improper calculation of escrow payments, among other things. She found Wells Fargo negligent and assessed damages, sanctions and legal fees of $27,350.

The heart of the case is that Wells Fargo failed to notify the borrower when it assessed fees or charges on her account. This deepened her default and placed her on a downward spiral that was hard to escape. And Wells Fargo's practice of not notifying borrowers that they were being charged fees "is not peculiar to loans involved in a bankruptcy," the court said.

During a 12-month period beginning in 2001, for example, Well Fargo assessed 13 late fees totaling $360.23 without telling Ms. Stewart or her late husband, whose name was on the loan before he died. Even though the terms of the mortgage required that Wells Fargo apply any funds it received from the Stewarts to principal and interest charges first, the late fees were deducted first. This meant that the Stewarts' mortgage payments were insufficient, making them fall further behind — and keeping them subject to more late fees.

Then there were the multiple inspection fees Wells Fargo charged the borrowers. Because its computer system automatically generates a request for property inspections when a borrower becomes delinquent —

to make sure the property is being kept up — the $15 cost of the inspections piled up. The court noted that the total cost to the borrower for one missed $554.11 mortgage payment was $465.36 in late fees and property inspection charges.

FROM late 2000 and 2007, Wells Fargo inspected the property on average every 54 days, the court found. But the court also determined that inspections charged to Ms. Stewart had often been performed on other people's properties. Of the nine broker appraisals charged to Ms. Stewart from 2002 to 2007, two were said to have been conducted on the same September day in 2005 when Jefferson Parish, where the Stewart home was located, was under an evacuation order because of Hurricane Katrina.

The broker appraisals were conducted by a division of Wells Fargo that charged more than double its costs for them, the court found. It concluded that the charges were an undisclosed fee disguised as a third-party vendor cost and illegally imposed by Wells Fargo. The bank also levied substantial legal fees and failed to credit back to the borrower $1,800 that had been charged for an eviction action but that had been returned by the sheriff because it never occurred.

While Wells Fargo claimed that the borrower owed $35,036, the judge said the actual figure was $24,924.10. The judge ordered Wells Fargo to provide a complete loan history on every case pending with her court after April 13, 2007.

A Wells Fargo spokesman said the bank "strongly disagrees with many aspects of the recent bankruptcy rulings in New Orleans and plans to appeal these matters. Wells Fargo continuously works to enhance its bankruptcy procedures to comply with the requirements of the bankruptcy courts throughout the country."

The second illuminating case emerged in federal bankruptcy court in Delaware and involved a problem that lawyers representing troubled borrowers say they often encounter: fees levied after a borrower has satisfied all obligations under a Chapter 13 bankruptcy and the case is discharged.

Mortgage lenders argue that their contracts allow them to recover all the fees and costs they incur when a borrower files a Chapter 13 bankruptcy plan, even those not approved by the court and charged after a case is resolved. But borrowers contend that because such charges have not been approved, they should be disallowed.

Judge Brendan Linehan Shannon put forward this example: If a lender imposed $5,200 in charges on a borrower to cover weekly property inspections and the court disallowed $4,000 of it, lenders still contend that they have the right to try to collect fees after the case concluded that the court did not approve.

"This cannot be," the judge wrote. "If the court and the Chapter 13 Trustee fully administer a case through completion of a 60-month Chapter 13 plan, only to have the debtor promptly refile on account of accrued, undisclosed fees and charges on her mortgage, it could fairly be said that we have all been on a fool's errand for five years."

Finally, borrowers can be cheered by an opinion written this month by Cecilia G. Morris, bankruptcy judge in the Southern District of New York.

The case involved Christopher W. and Bobbi Ann Schuessler, borrowers who had $120,000 of equity in their Burlingham, N.Y., home when their bank, Chase Home Finance, a unit of JPMorgan Chase, moved to begin foreclosure proceedings. The couple had filed for personal bankruptcy protection, which automatically prevents any seizure of their home.

But the bank moved for a so-called relief from the bankruptcy stay, and claimed the couple had no equity.

The Schuesslers got into trouble because Chase had refused a mortgage payment they tried to make at a local branch. Testimony in the case revealed a Chase policy of accepting mortgage payments in branches from borrowers who are current on their loans but rejecting payments from borrowers operating under bankruptcy protection.

The Schuesslers did not know this. When Chase rejected their payment, they briefly fell behind on their mortgage, according to the court documents. Then Chase moved to begin foreclosure proceedings.

"Without informing debtors, Chase Home Finance makes it impossible for JPMorgan Chase Bank branches to accept any payments," Judge Morris wrote. "It appeared that Chase Home Finance intended to commence an unwarranted foreclosure action, due to 'arrears' resulting from Chase Home Finance's handling of the case in its bankruptcy department, rather than any default of the debtors."

COURT documents also state that Chase was unable to show that it had tried to communicate with the borrowers before it began efforts to seize their home. The judge concluded that the way Chase deals with bankruptcy debtors is an abuse of the process. She instructed Chase to pay the borrowers' legal fees.

Thomas Kelly, a Chase spokesman, conceded that the bank had made some mistakes in the Schuessler case, especially the fact that the branch teller had not advised the borrowers where to send their payment when it was rejected.

"Payments from customers in bankruptcy require special handling under bankruptcy law so tellers are requested to tell customers to mail in the payment or call the toll-free number on the back of the form," he said. "In light of the judge's concerns we are reviewing our practices." He also said the bank had followed industry practice in moving to foreclose quickly "so we could meet the guidelines for servicing loans for investors."

"These cases clearly indicate that bankruptcy courts are no longer being fooled by the maze of fees, firms and flim-flams of the mortgage servicing industry," said O. Max Gardner III, a lawyer who represents borrowers in Shelby, N.C. "The servicers and their lawyers should recognize the clear and present danger of these decisions while they still have time to turn their ships around and do the right thing."

THE UNIVERSITY OF IOWA

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

Before the
United States Senate Committee on the Judiciary
Subcommittee on Administrative Oversight and the Courts

May 6, 2008

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

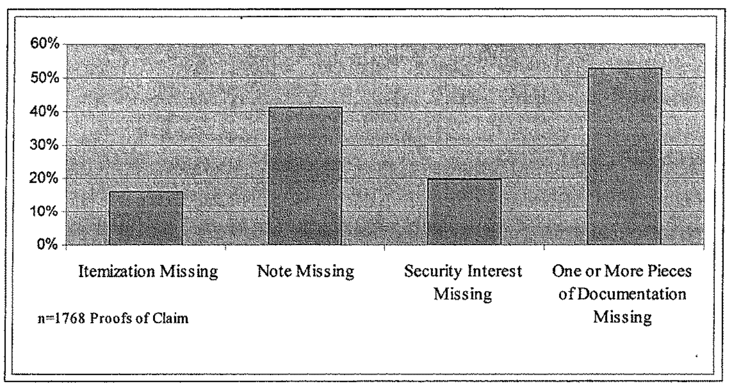
- Attempting to foreclose after a debtor receives a bankruptcy discharge despite the debtor properly making all payments during the bankruptcy plan

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.

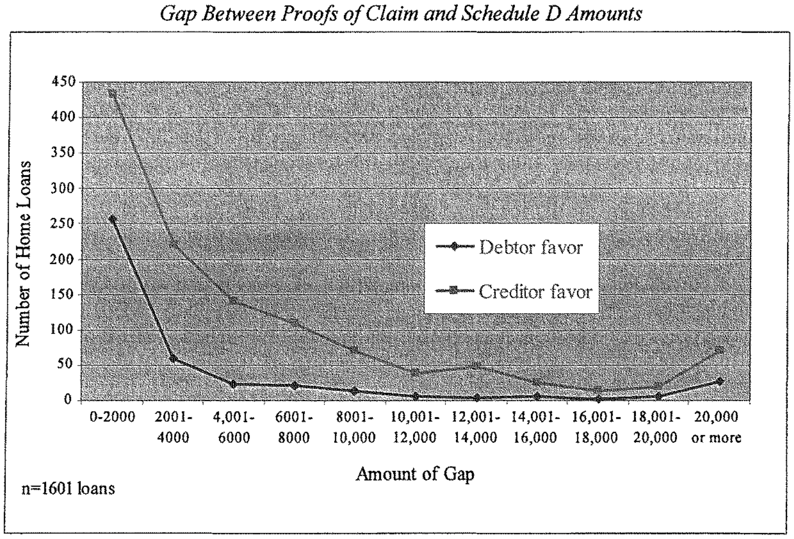
In the rare instances when courts do scrutinize the nature of mortgage claims, they frequently find evidence of servicer misbehavior. For example, Wells Fargo recently was faulted for charging a debtor for a broker price opinion, a form of appraisal, after it had completed the foreclosure and the debtor 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, *see* 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).

Senator Charles E. Schumer
Senate Judiciary Subcommittee on Administrative Oversight and the Courts
Opening Statement
May 6, 2008

Over the past year, we have heard much about the questionable lending practices that have harmed homeowners, roiled Wall Street, and stalled the economy – especially the ways that greedy lenders preyed on borrowers with subprime loans that many did not understand and could not afford.

What is far less known is the way that unscrupulous mortgage lenders and servicers have mistreated some of those same borrowers a second time – when they're down and out and at their most vulnerable – in bankruptcy.

There is a disturbing pattern of piling on that we need to get to the bottom of.

So today, I want to pull the curtain back on a hidden corner of the mortgage crisis.

As bankruptcies swell and defaults rise and revenue streams dry up, I fear a vulture mentality is developing in some quarters.

And that vulture mentality threatens to turn the dream of home ownership into an even worse nightmare than it has been for many already.

A homeowner is down on her luck and is forced to file for bankruptcy. She successfully completes a repayment plan to keep her home through Chapter 13 protection. There has been no foreclosure because she has rationally tried to keep her home, through a Chapter 13 workout.

But she then receives word that she owes more money on her mortgage than on the day she filed for bankruptcy or has to fight off foreclosure even though she has been making payments like clockwork.

How does this happen? How are these companies able to prey on homeowners with such impunity?

As Professor Kate Porter – who is a witness here today – has meticulously documented, they do it through a maze of dubious and undocumented fees.

All too often these charges are inflated, duplicative, or made-up. Just as often, they are undocumented, undisclosed, and just plain unlawful. They include:

- Late fees
- Demand fees
- Overnight delivery fees
- Fax fees
- Payoff statement fees

- o Property inspection fees; and
- o Legal service fees

This is death by a thousand fees.

And the companies know that the hapless homeowner is too poor, too unsophisticated or too overwhelmed to challenge often blatantly fraudulent demands for payment.

Lest anyone think I am exaggerating the problem, consider the record.

As Judge Joel B. Rosenthal has noted, an increasing number of lenders, "in their rush to foreclose, haphazardly fail to comply with even the most basic legal requirements of the bankruptcy system."

The catalogue of alleged misconduct is too long to list in full detail here, but companies have:

- repeatedly sought to foreclose on homes where owners were current on payments;
- sought attorneys fees in bankruptcy court for motions that they have lost; and
- failed to keep even the most basic records to justify their claims in bankruptcy court.

Consider some of the stories that are unfortunately becoming routine in this lesser known corner of the subprime crisis:

In the case of Sharon Diane Hill in Pittsburgh, Countrywide has admitted fabricating documents to wring dubious payments from a homeowner in bankruptcy.

Judge Thomas P. Agresti, had this to say about Countrywide's alleged fabrication of letters: "These letters are a smoking gun that something is not right in the state of Denmark."

In the case of John and Robin Atchley, Countrywide twice wrongly tried to foreclose on their home when they were actually current on their payments.

In that case, the Regional Trustee for the Atlanta area wrote in a brief that "Countrywide's failure to ensure the accuracy of its pleadings and accounts in [the Atchley] case is not an isolated incident."

Indeed, Countrywide today says problems exist in only a small number – maybe 1% of their case (or about 650 of the 65,000 cases Countrywide has in bankruptcy). But court records seem to tell a dramatically different story.

In just one judicial district alone – the Western District of Pennsylvania alone – the Trustee is so concerned, he is looking at 300 cases involving trouble with Countrywide.

Given that fact alone, the 1 percent numbers seems dubious, to say the least.

But the questionable behavior is by no means limited to Countrywide. Unfortunately, it seems dubious practices may span the loan servicing industry:

Consider the case of Jacalyn Nosek in Massachusetts, who desperately tried to save her home by diligently paying off her debts over five years in Chapter 13.

But Ameriquest, the company servicing her loan botched receipt of her payments so badly, they practically ruined her credit and made it impossible for her to refinance.

Said Ms. Nosek of how she was treated: "I felt like somebody hit me in the stomach . . . and you know, sucker-punched me . . . I became tremendously depressed, and really since then I haven't been able to get my feet under me."

The Court agreed with that assessment and sanctioned Ameriquest to the tune of $500,000 in punitive damages and $250,000 for emotional distress.

In the case of Pearl Maxwell, an 83-year-old Massachusetts woman with limited education, Fairbanks Capital Corporation took advantage of her by repeatedly demanding payments from her that she didn't owe. The bankruptcy court lambasted the company's conduct, calling it "egregious and inexcusable."

In another case, in the Northern District of Texas, a company filed a proof of claim that it was owed more than $1 million, when the principal balance on the note was only $60,000.

The list goes on and on.

And the bad behavior is not even limited to mortgage companies. Law firms also have gotten into the act.

For instance, one federal bankruptcy judge has criticized what he called a "corrosive assembly line culture of practicing law."

Another bankruptcy judge had this to say: "Above all else, what kind of culture condones its lawyers lying to the court and then retreating to the office hoping that the Court will forget about the whole matter?"

We invited a law firm to testify about its practices, but it refused, claiming over-broadly that the attorney client privilege prevented its appearance.

I hope today we can begin to get to the bottom of this practice of piling on.

To be sure, there is some good news.

The United States Trustee program has launched a series of investigations into these practices, as we will hear about today.

Judges are finally starting to hold these firms accountable.

And now, Congress will play its part.

My message to unscrupulous lenders and servicers should be heard loud and clear: Congress will no longer countenance this vulture mentality.

We will not stand for the continued abuse of homeowners who have worked hard and played by the rules of bankruptcy – only to have their homes and credit ratings and livelihoods threatened by misconduct at the hands of greedy corporations who made poor bets in the first place.

Given the record, I think the burden has shifted to these mortgage companies to demonstrate that their bad practices do not form an intentional pattern or deliberate business strategy.

There are too many horror stories, too many investigations, too many sanctions imposed for us to simply take the word of a company spokesman that "mistakes were made" and that they were few in number. We need a thorough and public accounting of industry practices.

Let me make a point on Countrywide here. I've always wondered why Bank of America – an outstanding institution with a great reputation – was willing to purchase Countrywide, given its recent history, and I understand that there has been encouragement by the financial regulators to make this transaction happen.

These latest revelations should make Bank of America think even harder about how they want to proceed with the deal.

If it turns out that the purchase price for Countrywide was based in part on profits from these bad practices, Bank of America should demand a lower price, because these practices will not be allowed to continue.

As we go forward, we will look closely at any and all solutions to these problems.

Do we need better deterrence? Stiffer penalties? More robust disclosures?

We will consider any and all such options. I look forward to hearing from all of our witnesses.

I now recognize Senator Sessions for an opening statement.

Department of Justice

STATEMENT OF

CLIFFORD J. WHITE III
DIRECTOR
EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS
UNITED STATES SENATE

HEARING ENTITLED

"POLICING LENDERS AND PROTECTING HOMEOWNERS: IS MISCONDUCT IN BANKRUPTCY FUELING THE FORECLOSURE CRISIS?"

PRESENTED

May 6, 2008

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Mr. Chairman, Ranking Member Sessions, and Members of the Subcommittee:

Thank you for the opportunity to appear before you today to describe the activities of the United States Trustee Program (USTP or Program) to protect homeowners who file for bankruptcy relief. We are the component of the United States Department of Justice with a duty to oversee bankruptcy cases, ranging from consumer bankruptcy cases to large corporate reorganizations. Our mission is to promote the integrity and efficiency of the bankruptcy system.[1/] Our responsibilities, which are set forth in titles 11 and 28 of the United States Code, include the performance of administrative, regulatory, and litigation functions.

The duties of the USTP are carried out by the Executive Office for United States Trustees, 21 regional United States Trustees, and 95 field offices. The Program employs approximately 1,300 staff, including trial attorneys, financial analysts, and support staff.

Civil and Criminal Enforcement

One of the core functions of the USTP is to combat bankruptcy fraud and abuse. This is reflected both in our statutory mandate and in our track record over the past 20 years. In launching a Civil Enforcement Initiative in 2002, the Program adopted a balanced approach to address wrongdoing both by debtors and by those who exploit debtors. The Program combats fraud and abuse by debtors by seeking denial of discharge for the concealment of assets and other violations, by seeking case dismissal if a debtor has an ability to repay debts, and by taking other enforcement actions. We protect consumer debtors from wrongdoing by attorneys, bankruptcy petition preparers, creditors, and others by pursuing a variety of remedies, including the disgorgement of fees, the imposition of fines, and injunctive relief.

In Fiscal Year (FY) 2007, the Program initiated more than 74,000 civil enforcement and related actions, including actions not requiring court resolution, with a monetary impact of more than $865 million in debts not discharged, fines, penalties, and other relief. Since we began tracking our results in 2003, we have taken more than 290,000 actions with a monetary impact in excess of $3.5 billion.

Criminal enforcement is another key component of the Program's efforts to uphold the integrity of the bankruptcy system. We have a statutory duty to refer suspected criminal conduct to the United States Attorney and to assist in prosecuting bankruptcy crimes. We participate in more than 50 local working groups, including bankruptcy fraud working groups, mortgage fraud working groups, and other specialized task forces that are led by federal law enforcement agencies around the country. We also work closely with the Federal Bureau of Investigation, the Internal Revenue Service - Criminal Investigation, the Office of Inspector General of the Department of Housing and Urban Development, and other federal law enforcement agencies.

[1/] The USTP has jurisdiction in all judicial districts except those in Alabama and North Carolina. In addition to specific statutory duties and responsibilities, United States Trustees "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307.

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In FY 2007, we made 1,163 criminal referrals, including cases involving housing fraud. This represents an increase of 26 percent in the number of cases formally referred over the previous year. Furthermore, the number of cases referred in FY 2006 represented an increase of 24 percent over the previous year.

Protecting Homeowners in Bankruptcy

Protecting consumer debtors is an important objective of the Program's enforcement efforts. One of the basic principles of our bankruptcy system is that the honest but unfortunate debtor deserves a fresh start. Those who prey upon debtors for their own financial gain undermine that basic principle.

Among the most egregious mortgage-related schemes we encounter are those perpetrated upon consumers facing foreclosure on their homes. From our experience, it sometimes seems that those facing foreclosure on their homes receive more mail than any other group of Americans. As soon as a foreclosure notice is posted in a public record, debtors are apt to receive flyers and other mailings telling them how to save their homes. Although debtors are vulnerable to a wide variety of fraudulent schemes or other improper conduct, two of the fact patterns uncovered most often by United States Trustees are described below.

Bankruptcy Petition Preparers

A common problem we see in the bankruptcy system is the distressed homeowner's use of a bankruptcy petition preparer. Instead of going to see a lawyer, some seek a less expensive alternative. A debtor is not required to retain an attorney before filing for bankruptcy. Some non-attorneys perform a legitimate service by providing and typing bankruptcy forms at a charge of $200 or less. Unfortunately, however, we frequently learn about homeowners in need of debt relief who turn to a non-lawyer bankruptcy petition preparer (BPP) who provides advice that is both illegal and catastrophically wrong. Non-attorneys are not permitted to offer legal advice. If a debtor owns a home, many factors go into whether to file a chapter 7 or a chapter 13 petition.[2/] Legal issues such as the amount of equity in the home, availability of state exemptions, calculation of disposable income to make up for mortgage arrearages, and other factors need to be carefully considered before deciding whether to file bankruptcy and under which chapter to file.

Following are two examples of improper bankruptcy petition preparer conduct pursued by United States Trustees:

[2/] In general, debtors in chapter 7 give up all non-exempt property to a case trustee appointed by the United States Trustee. The chapter 7 trustee liquidates non-exempt property and distributes the proceeds to creditors. Debtors in chapter 13 retain their home and other property, but must remain current on post-petition secured debt payments (e.g., mortgage and auto loans). Chapter 13 debtors also must make up any pre-petition arrearages on secured debts and repay at least a portion of unsecured debts (e.g., credit card obligations) under a three to five year repayment plan.

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- In a series of cases in New York City, homeowners who fell behind on their debts responded to an advertisement from a BPP. When the debtors went to the BPP's office, the BPP filled out chapter 7 forms, collected a fee, and then filed the bankruptcy petition. The next thing the debtors knew, they were attending a formal meeting of creditors presided over by a trustee where they learned for the first time that the trustee planned to take their home, sell it, and distribute the proceeds to creditors. After the debtors told their story, we were able to obtain both injunctive relief against the BPP, prohibiting it from the unauthorized practice of law, and affirmative relief requiring the BPP to make disclosures to future clients regarding the nature and cost of its services. More importantly, the affected debtors were able to convert their cases to chapter 13 where they could retain their homes.

- In another case decided within the past year, the bankruptcy court in the Western District of Pennsylvania entered a default judgment against a BPP following a complaint filed by the Office of the United States Trustee. The out-of-state BPP contacted several Pittsburgh area residents faced with foreclosure by mailing a postcard that guaranteed the BPP could help them keep their homes. In exchange for fees ranging from $250 to $2,100, the BPP provided the homeowners with skeletal chapter 13 petitions to file to stay foreclosure. The debtors' bankruptcy cases were ultimately dismissed. The court fined the BPP $72,000, ordered the disgorgement of fees in the amount of $8,200, and permanently enjoined it from acting as a BPP and offering legal advice or otherwise engaging in the unauthorized practice of law in the district.

Foreclosure Rescue Operators

Another frequent fact pattern involves foreclosure rescue operators who use the bankruptcy system to victimize distressed homeowners. The perpetrators of this fraud promise to assist the victims in saving their homes from foreclosure. By filing bankruptcy petitions, the fraudsters use the automatic stay[3/] to delay foreclosure and to convince the victims that they are performing a valuable service.

In one variation of this scheme, the perpetrator promises to renegotiate the terms of the victim's mortgage. The fraudster often directs the victim to make mortgage payments to him or to pay him a monthly fee. In reality, the fraudster does nothing except pocket the victim's money. To ensure the victim will continue to pay the perpetrator, and to prevent foreclosure in spite of the non-payment of mortgage, bankruptcy petitions may be filed in the name of the victim.

If the perpetrator is filing the bankruptcy papers without the debtor's knowledge, it may be a long time before the debtor learns about the bankruptcy. In such cases, it is critical that the homeowners contact a lawyer, the bankruptcy court, or the United States Trustee as soon as they become aware that a bankruptcy petition was filed in their name.

[3/] By statute, the filing of a bankruptcy petition generally stays any actions to collect on debts, including actions to foreclose on a debtor's residence.

In another scenario, the "rescue servicer" takes the debtor's equity and the home ultimately is lost to foreclosure. In these cases, the fraudster seeks out individuals who are losing their homes to foreclosure and prevails upon them to transfer their homes to him to avoid a foreclosure on their credit reports. To stop the foreclosure, the rescue operator files bankruptcy petitions in the homeowners' names. While the cases are pending, he collects rental income on the properties from the victims.

Following are four recent cases involving criminal prosecution:

- In Kansas, a Los Angeles man was charged in an indictment unsealed on February 29, 2008, with six counts of mail fraud and six counts of aggravated identity theft for his role in a bankruptcy foreclosure scheme. The defendant allegedly solicited homeowners whose homes were in foreclosure, and told them that for a fee he could help them keep their homes. He allegedly filed false bankruptcy petitions in the names of non-existent businesses that claimed to be part owners of the properties in foreclosure. The petitions were filed in the Bankruptcy Court for the District of Kansas, and contained false names, Social Security numbers, and other information. The United States Trustee in Kansas referred the matter and assisted in the investigation. A copy of a news release issued by the United States Attorney announcing the indictment is attached.

- In the Northern District of Illinois, a defendant was sentenced on June 25, 2007, after pleading to wire fraud and false declaration in bankruptcy. The defendant preyed on homeowners facing foreclosure by making false representations that the defendant's company and its team of experts could stop foreclosures and eliminate all of a homeowner's mortgage debt in two years. The defendant falsely represented to some of his victims that mortgage debt was illegal and that the mortgage companies would forgive their debt when faced with lawsuits and persuasive arguments. The defendant charged the homeowners a large retainer as well as monthly payments, but essentially did nothing except file serial bankruptcy petitions to delay foreclosure. Approximately 29 victims lost a total of around $180,000, and all eventually lost their homes. The defendant was sentenced to 135 months incarceration and six years of supervised release, and was ordered to make restitution in the amount of $187,604. The United States Trustee in Chicago referred the matter and a USTP Regional Criminal Coordinator assisted in the prosecution as a Special Assistant U.S. Attorney.

- In the Northern District of Ohio, a Grand Jury returned an indictment last December alleging that the defendant committed eight counts of mail fraud. The indictment alleges that the defendant engaged in a scheme to defraud financially troubled homeowners. The indictment states that the defendant made representations that his company specialized in helping people save their homes from foreclosure with highly trained and qualified specialists. The indictment charges that the defendant requested and received funds from these homeowners to be used to pay their mortgage lenders, but that he instead used these funds for his own personal and

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business purposes. The indictment states that the defendant fraudulently obtained approximately $500,000 from various homeowners. The indictment further alleges that the defendant hired attorneys to prepare and file bankruptcy petitions on behalf of the homeowners to delay foreclosure actions. A Trial Attorney from the Cleveland office of the United States Trustee is assisting in the prosecution of the case as a Special Assistant U.S. Attorney.

- In Arizona, last August a foreclosure rescue operator was sentenced to 33 months in prison, fined $5,000, and ordered to pay $86,409 in restitution, based on his guilty plea to two counts of false declaration in bankruptcy. The operator sought out individuals who were losing their homes to foreclosure and prevailed upon them to transfer their homes to him to avoid having a foreclosure on their credit reports. To stay foreclosure, he filed bankruptcy petitions in the homeowners' names without their knowledge. While the cases were pending, he collected rental income on the properties. When we were alerted to the scam, we took action to remove the bankruptcy filing from the debtors' records and worked closely with the United States Attorney on the criminal prosecution. A copy of a news release issued by the United States Attorney announcing the sentencing is attached.

Mortgage Servicer Violations in Bankruptcy Cases

Apart from the kind of fraudulent or improper activities described above, we also have been involved in significant litigation involving national mortgage servicing firms. Most of these cases involve homeowners who are behind on their mortgage payments and file for relief under chapter 13 of the Bankruptcy Code. To date, we have commenced actions or intervened in 16 pending cases involving mortgage servicers in eight judicial districts around the country. In addition, we are actively reviewing more than 30 cases in which we have not yet filed court papers.

The USTP has investigated complaints that some mortgage servicers were filing inaccurate papers in court claiming that debtors owe more money than they actually owe. We also investigated complaints that some mortgage servicers were tacking on charges that were undisclosed and impermissible under the terms of the loan contract or other applicable law. In the most extreme cases, the debtor makes all payments required in chapter 13 and, after emerging from bankruptcy, is hit with a new bill for previously undisclosed charges. If those new bills are not paid, then the lender can foreclose on the property and the entire chapter 13 process will have been for naught.

More specifically, the United States Trustee has investigated or pursued actions involving mortgage servicers who inflate the amount of money due from the debtor in two primary ways:

- *Proof of Claim.* Creditors are generally required to file with the court a proof of claim stating the amount owed by the debtor. In the case of a mortgage debt, the proof of claim should reflect the principal due and the arrearages from pre-petition missed payments. If the homeowner wishes to retain the home, then the arrearage must be repaid under a three to five year chapter 13 repayment plan. We have investigated or taken action against mortgage servicers who file proofs of claim in inflated amounts that are not documented by reliable billing records.

- *Motions for Relief from Stay.* By filing a bankruptcy petition, the debtor receives an automatic stay preventing creditors from taking any collection action on most debts without a court order. Generally, chapter 13 debtors may keep their home if they can make up past due payments as described above and remain current in their post-petition mortgage payments. If debtors are delinquent in their post-petition payments, the creditor may seek relief from the stay and foreclose on the property. We have investigated or taken action against mortgage servicers who file motions for relief from stay based upon inaccurate financial information. For example, the mortgage servicer may misapply post-petition plan payments or add various charges, such as high attorneys' fees, that are not permissible under the mortgage contract or applicable law. Unless the mortgage servicer's accounting is challenged, then the court may grant the relief from stay and the debtor may be subject to foreclosure.

In response to an increasing number of complaints about the accuracy of bankruptcy court filings made by some mortgage servicers, approximately 18 months ago, I established an informal working group within the USTP to review the complaints and devise a coordinated approach for addressing the problem. The working group considered many legal and practical issues. As a threshold matter, it is not always clear when the United States Trustee should intervene in a case. We take the legal position that the Program has authority to redress violations by creditors, particularly when the abuse is systemic or multi-jurisdictional. In many cases, however, creditor abuse is best addressed by the private case trustees we appoint who object to claims, or by debtors' lawyers who dispute loan agreement terms. The Program should focus its attention on cases in which the integrity of the bankruptcy system as a whole is at stake. In those cases that have broader, system-wide implications, it is important for the Program to take direct enforcement action.

In addition to the difficulty of case selection, civil litigation of mortgage servicing issues requires resource intensive fact finding and resolution of strongly contested legal issues. In one recent case, we completed seven days of trial, examined 22 witnesses, and reviewed thousands of pages of documents. Moreover, a creditor's procedural obligations under chapter 13 may be quite different under disparate local court rules, practice, and case law. In addition, our standing to intervene has been challenged and litigation over that issue can slow down our investigation and civil prosecution.

Insofar as we are currently in litigation and discovery in many mortgage servicer cases, it would not be appropriate to discuss these cases in detail. However, a summary of three recent bankruptcy court decisions is provided below.

- In re Countrywide Homes Loans, Inc., __ B.R. __, 2008 WL 868041 (Bankr. W.D. Pa. Apr. 1, 2008). The bankruptcy court consolidated several cases for administrative purposes to resolve the creditor's challenge to the authority of the United States Trustee to examine Countrywide's mortgage servicing practices. In a lengthy opinion handed down on April 1, 2008, the bankruptcy court ruled in favor of the United States Trustee. The court declared that "the UST was undoubtedly intended to be a 'watchdog' of the bankruptcy system" and, in the cases at bar, "made a showing of a common thread of potential wrongdoing in each of the cases that is sufficient to meet the general standard of good cause necessary" to proceed.

- In re Parsley, __ B.R. __, 2008 WL 622859 (Bankr. S.D. Tex. Mar. 5, 2008). After several days of trial and extensive briefing on legal and factual issues arising in the case, the bankruptcy court handed down a 72 page opinion resolving Orders to Show Cause against a mortgage servicer and its counsel. The United States Trustee argued that Countrywide Home Loans, Inc., or its outside counsel should be sanctioned for bad faith conduct for repeatedly averring inaccurate facts in papers filed with the court. The court earlier had upheld the United States Trustee's standing to pursue the matter. The court noted that "[t]he level of vituperation against the UST merits some discussion of the UST's role in the bankruptcy system." The court concluded that "the UST was well within its authority to investigate" the mortgage servicer and its counsel "to determine if their activities undermined the integrity of the bankruptcy system," and stated that the United States Trustee's litigation "has been very thorough and skillful." Although the court found many instances of inaccurate court filings and inappropriate conduct, and criticized the mortgage servicer's "corporate culture," the court did not impose additional sanctions. The court reasoned that sanctions required a heightened burden of proof beyond negligence, the parties already had suffered some penalties, and the parties had taken some corrective actions.

- In re Allen, No. 06-60121, 2007 WL 1747018 (Bankr. S.D. Tex. June 18, 2007). The bankruptcy court imposed sanctions of $150,000 against a law firm representing mortgage servicers. The court found that the law firm repeatedly filed motions for relief from the stay to permit foreclosure based upon inaccurate statements of the amount of past due debt. The sanction was remitted to $75,000 because the law firm was attempting to cure its deficiencies. As in other cases, the court noted that the respondent had "complained bitterly about the participation of the U.S. Trustee in this matter," but found that we were a "party in interest with the authority to be heard," and "provided an invaluable benefit to the case and to the process . . . ."

Mortgage Lenders in Chapter 11 Bankruptcy

In addition to addressing issues pertaining to homeowners in bankruptcy, the Program has responsibility for overseeing chapter 11 business reorganization cases filed by mortgage lenders. Although our case management system does not identify business debtors by industry, we estimate that at least 20 mortgage lenders have filed for chapter 11 relief over the past two years.[4] Some of these business debtors are subprime lenders and some of the cases raise questions regarding sound business practices.

Under chapter 11, business debtors[5] obtain a stay to prevent creditors from collecting on pre-petition debt while the company develops a plan of reorganization that must be approved by creditors and the court. Management of the debtor usually is allowed to remain in place, but the bankruptcy filing transforms the company into a "debtor in possession" with a fiduciary duty to act in the interests of all stakeholders of the company, including creditors.

The USTP carries out numerous responsibilities in a chapter 11 case. Importantly, the Program does not substitute its business judgment for that of the debtor's management or creditors. Instead, we perform various administrative duties and ensure compliance with Bankruptcy Code provisions. For example, we appoint an official committee of unsecured creditors who act as fiduciaries to represent the interests of unsecured creditors in negotiating with the debtor over a plan of reorganization and other matters; prescribe financial reports that must be filed by the debtor with the court; conduct a formal meeting where the debtor's representatives testify under oath about the company's financial condition; review and sometimes object to applications of professionals who seek to be employed and compensated by the bankruptcy estate; and take other steps to ensure that the case proceeds in accordance with bankruptcy statutes and rules.

The recent case of New Century TRS Holdings, Inc., points out the important role of the United States Trustee in moving for the appointment of a trustee or independent examiner in the face of what frequently is strong opposition from the debtor and its large institutional creditors. In cases involving gross mismanagement by the debtor in possession, an independent trustee or examiner can add transparency, enhance public confidence in the proceedings, and conduct efficient fact-finding for the benefit of creditors and equity holders. New Century is the largest mortgage lender to file for chapter 11 relief, with stated assets of $12.9 billion and stated liabilities of $11.5 billion when it filed on April 2, 2007.

Replace Management or Appoint Independent Examiner

New Century filed for bankruptcy relief in the district of Delaware after disclosing accounting and financial statement irregularities in the operation of its business. The company acknowledged that it needed to restate its financial results and amend its previous filings with the Securities and Exchange Commission. The misstatements were significant and hid major losses from New Century's creditors and investors.

About two weeks after New Century filed for bankruptcy relief, the United States Trustee filed a motion for authority to appoint a trustee to replace existing management or, in the alternative, an independent examiner. Under chapter 11, the United States Trustee or other

[4] In addition, a number of mortgage lenders filed for relief under the liquidation provisions of chapter 7 during this same period of time.

[5] Under certain circumstances, individuals may be a debtor under chapter 11.

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parties may seek to oust management for fraud, mismanagement, or other reasons set forth in section 1104 of the Bankruptcy Code. If the motion is granted, the United States Trustee appoints a trustee to take control of the debtor. In New Century, there was opposition by both the debtor and creditors to the appointment of a trustee, and the bankruptcy court declined to authorize such an appointment.[6] It did, however, grant our request for authority to appoint an independent examiner to report on the financial affairs of the debtor and possible causes of action that may be pursued on behalf of the estate and its stakeholders.

After protracted negotiations and argument in open court over the scope of the examination, the examiner finally was allowed to commence his investigation in mid-2007 with a deadline to file one or more reports with the court by early 2008. After filing an interim report, the examiner filed his final report on February 29, 2008. The creditors' committee sought to seal the report from public view for at least 45 days. The United States Trustee opposed the seal and the court unsealed the report on March 26, 2008.

The examiner's report provides a detailed account of New Century's business practices and outlines possible causes of action against culpable parties, including the company's former auditors. In this respect, the examiner's report in New Century is similar to results of independent examinations sought by United States Trustees in other cases.

Limit Executive Bonuses

The United States Trustee also has an important responsibility to review proposals to pay bonuses to executives of bankrupt companies. One of the reforms made by the 2005 bankruptcy law is a provision that severely restricts payments to executives and insiders. Among other things, section 503(c) of the Bankruptcy Code prohibits most retention bonuses and, generally, requires that bonuses to senior officials be based upon achievement of bona fide performance goals. The United States Trustee is often the only party objecting to executive bonuses that do not comply with the new law.

Nine days after New Century filed, the debtor proposed payments of more than $2.8 million to eight top company officials. The United States Trustee filed objections on grounds that the payments were disguised retention bonuses unrelated to performance and that it was premature to reward senior executives while the company's pre-petition financial conduct was being investigated. The debtor later modified its bonus plan and, among other things, excluded the Chief Executive Officer from those eligible to receive bonus payments. The United States Trustee maintained its objection to the amended plan, but our objection was overruled by the bankruptcy court.

Despite resource constraints, the United States Trustee remains committed to carrying out its duties in chapter 11 cases to ensure compliance with legal requirements and, where appropriate, to seek authority to appoint trustees or examiners who can bring independence, transparency, and efficiency of the bankruptcy process.

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[6] The President and Chief Executive Officer as well as the Executive Vice President were subsequently dismissed on June 12, 2007.

Conclusion

The mission of the USTP is to carry out the bankruptcy laws for the benefit of all stakeholders in the system – debtors, creditors, and the public. The integrity of the bankruptcy system is threatened whenever debtors violate the Bankruptcy Code by seeking a discharge of debt despite their ability to pay creditors out of disposable income or by concealing assets that should be liquidated for distribution to creditors. Similarly, the integrity of the bankruptcy system is compromised by creditors who file false financial information that inflates the amount of money due to them or deprives debtors of the Bankruptcy Code's protection against foreclosure. Actions to protect consumer debtors who may be victims of fraud or abuse have a high priority, have yielded positive results, and will continue to be aggressively pursued.

The United States Trustee Program also helps to ensure that mortgage lenders that seek bankruptcy relief comply with bankruptcy laws and that reasonable suspicions of financial irregularity are properly addressed, including by the appointment of independent case trustees or examiners.

I appreciate the opportunity to testify and would be pleased to respond to any questions from the Subcommittee.