$25 BILLION MORTGAGE SERVICER SETTLEMENT – IMPLICATIONS FOR THE UNITED STATES TRUSTEE PROGRAM AND THE BANKRUPTCY SYSTEM

Written by:

Clifford J. White III, Director, and
Ramona D. Elliott, Deputy Director/General Counsel
Executive Office for United States Trustees

On February 9, 2012, the Attorney General announced that the federal government and 49 state attorneys general had reached a settlement agreement with the nation's five largest mortgage servicers – Bank of America Corporation, JP Morgan Chase & Co., Wells Fargo & Company, Citigroup Inc. and Ally Financial Inc. (formerly GMAC)(collectively, "the servicers") – to address mortgage servicing, foreclosure and bankruptcy abuses. In the agreement, the United States Trustee Program ("USTP" or "Program") settled claims for the servicers' violations of bankruptcy requirements that protect debtors and ensure the integrity of the bankruptcy process. Under the settlement, the servicers will pay $25 billion in cash and financial relief to homeowners; adhere to a uniform and comprehensive set of mortgage servicing standards, including provisions specific to bankruptcy; and subject themselves to three and a half years of compliance review by an independent monitor.

The comprehensive settlement reflects unprecedented cooperation among federal and state enforcement and regulatory agencies, and represents a critical step forward in addressing the problems that have plagued the mortgage servicing industry. In his announcement of the settlement, Attorney General Holder praised the work of Associate Attorney General Thomas Perrelli, who led the negotiations, and also singled out the USTP, stating:

> In particular, I want to recognize the outstanding work of the Justice Department's United States Trustees Program, and our United States Attorneys' Offices.
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> The U.S. Trustees Program, which serves as the watchdog of all bankruptcy court operations, was one of the first federal agencies to investigate mortgage servicer abuse of homeowners in financial distress. As part of their investigation, Trustees reviewed more than 37,000 documents filed by major mortgage servicers in federal bankruptcy court – and took discovery in more than 175 cases across the country. These efforts were advanced by several United States Attorneys . . . They have worked tirelessly to seek justice for homeowners who were treated unfairly and taxpayers who footed the bill. And the information and evidence that these teams compiled – and the expertise they provided – was essential in reaching this historic settlement.

USTP History of Addressing Mortgage Servicer Misconduct

The settlement agreement is the culmination of several years of intensive investigation and litigation by USTP offices throughout the country. Even before the mortgage meltdown, allegations arose in the bankruptcy system that mortgage servicers were filing inflated and inaccurate proofs of claim and motions for relief from stay based upon faulty accounting and misrepresentations to the bankruptcy courts. In some cases, these allegations extended to the mortgage servicers' attorneys, as well as the third party vendors they retained to provide services with respect to borrowers in bankruptcy.

Beginning in late 2006, the USTP launched its initial review of the mortgage industry's practices in bankruptcy. The fruits of that resource-intensive project grew over time, and the USTP was successful in obtaining court decisions against mortgage servicers, their attorneys, and their agents. Significantly, in 2010, the USTP and the Federal Trade Commission reached a $108 million settlement with Countrywide Home Loans, Inc., and its affiliate BAC Home Loans Servicing, LP, for improper default servicing practices. That settlement resolved an FTC complaint and the USTP's litigation in bankruptcy courts across the country concerning Countrywide's mortgage servicing practices, including charges that Countrywide inflated mortgage claims made against homeowners in bankruptcy, failed to properly credit homeowners with payments made and failed to notify homeowners of extra charges added to their mortgage bill.

Just months later, the robo-signing scandal broke in the media, which focused national attention on the larger issue of the servicers' practices in servicing loans of homeowners in default.[1/] The Department of Justice, through Associate Attorney General Thomas Perrelli, convened federal regulatory and enforcement agencies to coordinate an investigation into the extent of the servicers' misconduct. The prudential banking regulators, including the Office of the Comptroller of the Currency and the Federal Reserve, participated and, with technical assistance from the USTP and others, undertook a review of the servicers' general mortgage loan servicing and foreclosure processing to determine compliance with state and federal laws.

As part of the DOJ-led enforcement effort, the USTP stepped up its investigation of select servicers in certain jurisdictions across the country by reviewing mortgage-related proofs of claim and contested motions for relief from the automatic stay. For several years, the USTP had been satisfied when servicers corrected their mistakes in the case at bar, but the mistakes continued and they were not confined by geographic districts or by servicer. It was clear that there was a protracted, widespread and national problem, so the USTP changed its strategy. If a filing was determined to be "facially deficient," the USTP sought discovery. As reported in the *New York Times* and elsewhere, the Program identified facial deficiencies such as the following:

[1/] Robo-signing is a term used to describe the practice of servicer employees, or the employees of vendors acting on behalf of the servicers, approving and signing large quantities of documents and affidavits without proper review or verification of the information contained therein and, in many instances, without complying with requirements of state notarization laws.

- A servicer filed a proof of claim asserting an arrearage of $52,042.58. After the debtor objected, the servicer amended the claim to reduce the arrearage to $3,156.02; it failed, however, to provide the required itemization. The servicer then filed a third claim in the corrected amount and with the required itemization.

- After a debtor made all chapter 13 plan payments, satisfied all chapter 13 requirements, and received a discharge, the servicer rejected the debtor's ongoing mortgage payments and threatened the debtor with foreclosure.

- A servicer obtained force-placed insurance even though the debtors had their own insurance. The servicer then sought relief from the stay, asserting an arrearage based on the erroneous insurance charges.

- A servicer filed a $30,000 arrearage claim primarily for missed payments. The servicer amended its claim twice and both times calculated the missed payments differently than it had originally. In addition, the supporting documentation attached to the first amended claim was for a property in Massachusetts that was not owned by the debtors.

- In three cases, a servicer filed proofs of claim requesting payment for "prior servicer fees" for amounts ranging from $3,178 to $10,260, but failed to provide supporting documentation, itemization, or other explanation. After the United States Trustee objected to the claims, the servicer agreed to amend the claims to eliminate the requests for these substantial fees.

Mortgage Servicer Challenges to the USTP

The initial response of the mortgage industry was that their errors were few in number and were not material. Servicers suggested that the USTP was being hyper-technical in focusing on inconsequential and isolated inaccuracies. In fact, these errors were both large and small, assaulted the integrity of the bankruptcy system, and compromised the ability of chapter 13 debtors to save their homes.

The servicers' response to the USTP's actions has been not only to oppose the USTP's discovery into their policies and procedures for the servicing of loans in bankruptcy, but also to attack the standing and authority of the USTP to investigate systemic abuse of the bankruptcy system.[2/] They even questioned the authority of the bankruptcy court to impose remedies.

[2/] In May 2011, three members of the Senate Judiciary Committee introduced legislation titled "Fighting Fraud in Bankruptcy Act of 2011." Among other things, the bill clarifies USTP authority to bring actions to remedy creditor abuse and it gives bankruptcy courts express authority to impose fines and enter nationwide injunctive relief. In addition, the bill gives the USTP authority to conduct audits of creditor proofs of claim in a manner similar to current statutory provisions governing audits of debtor schedules and statements of financial affairs. See Fighting Fraud in Bankruptcy Act of 2011, S. 1054, 112th Cong. (2011); see also 157 Cong. Rec. S3276-01 (daily ed. May 24, 2011) (statement of Sen. Leahy).

Incredibly, the top servicers stated in court pleadings that the USTP – the “watchdog of the bankruptcy system” – was charged only with making sure homeowner debtors followed the bankruptcy rules that protect creditors, and was not authorized to police creditor misconduct that might harm debtors. One servicer went so far as to argue in court that the Attorney General, acting through the Director of the Executive Office for United States Trustees, lacked authority to set enforcement priorities and coordinate multi-district investigations that would bind United States Trustees around the country.

During the course of its enforcement efforts, the USTP confronted close to 300 challenges to its discovery requests, including eight cases in which it was forced to file motions to compel, motions for orders to show cause, or motions for sanctions because the servicers simply refused to comply with discovery requests or court orders requiring the servicers to provide discovery. The USTP prevailed in the overwhelming number of adjudicated cases, but then faced motions for reconsideration and appeals. Though each court soundly rejected the servicers’ legal arguments concerning the standing and authority of the United States Trustees to conduct discovery and investigate servicing practices, unsettled questions remain as to the ability of the bankruptcy courts to mete out remedies to address systemic abuse.[3/] Under the settlement, however, failure to abide by the terms of the agreement may result in sanctions without the need for extended or complex litigation.

Intensive Negotiations

Associate Attorney General Perrelli convened relevant federal agencies and state Attorneys General beginning in early 2011 to discuss various regulatory and enforcement actions that were ongoing or contemplated. Given the head start the USTP had in investigating mortgage servicer practices, the Program was actively engaged in these discussions and was able to identify the most common violations that were occurring both in and out of bankruptcy.

Negotiations with the servicers started shortly thereafter. The negotiations were extremely lengthy because of the breadth of claims under consideration and the scope of relief. Each type of misconduct identified by the USTP is covered in this agreement. Among the bankruptcy claims resolved through the negotiations are those relating to:

- deficiencies in servicers’ foreclosure practices, including with respect to the preparation and content of documents filed with courts, or otherwise relied upon, as part of the foreclosure process;

- deficiencies relating to the servicers’ use and supervision of attorneys and other vendors in connection with the creation and recording of assignments, foreclosure and bankruptcy services and loss mitigation activities; and last, but certainly not least,

[3/] In *In re Stewart*, 647 F.3d 553, 558 (5th Cir. 2011), the United States Court of Appeals for the Fifth Circuit struck down injunctive relief imposed against the servicer on grounds that, among other things, the debtor in that case had settled her dispute with the servicer. In contrast, in *In re Taylor*, 655 F.3d 274, 288 (3d Cir. 2011), the United States Court of Appeals for the Third Circuit upheld sanctions against the servicer and its law firm by noting that the bankruptcy court properly considered the effect sanctions may have on future conduct.

- systemic deficiencies in servicers' bankruptcy practices resulting in inflation of claims, overcharging or improper charging of consumers with respect to default-related fees, misaccounting, payment application issues, documentation issues and misrepresentations in bankruptcy filings and proceedings.

Settlement Agreement

The settlement agreement covers a wide range of civil misconduct by servicers. The major provisions of the agreement include:

- The servicers will pay $25 billion to resolve violations of state and federal law. The majority of the payments (about $20 billion) will take the form of monetary credits applied towards the servicers' obligations to assist homeowners in financial distress, including through interest rate reductions, principal write-downs, refinancing, forbearance of principal, short sales and transitional assistance, and anti-blight programs. Additionally, about $1.5 billion will be used to establish a Borrower Payment Fund to provide cash payment to homeowners who meet certain criteria and whose homes were sold or taken in foreclosure. Going forward, servicers must also remediate harm to homeowners, which may include compensation, for failure to comply with new injunctive standards that govern their servicing practices.

- The servicers will adhere to a strict set of new mortgage servicing standards covering accuracy of account information; document preparation and verification; oversight and management of foreclosure and bankruptcy attorneys and other third party providers; quality assurance processes; foreclosure filing practices and processes; loan modification and loss mitigation practices; borrower communication and notification practices; and restrictions on servicing fees.

- The servicers will adhere to special provisions relating to bankruptcy conduct, such as establishing processes to ensure the accuracy of proofs of claim and motions for relief from stay; waiving "hidden fees" that were not disclosed during the chapter 13 case; waiving fees for the filing of proofs of claim and motions seeking relief from the automatic stay determined to contain a substantial misstatement of the amount due; providing special access for chapter 13 trustees to knowledgeable employees of the servicer who can respond to trustee inquiries; ensuring payments in chapter 13 cases are promptly and accurately credited; providing training to employees that specifically addresses the servicing of loans for borrowers in bankruptcy; taking corrective action where deficiencies in claims are identified; and providing remediation to debtors for inaccuracies in account information.

- Servicer conduct will be reviewed for three and a half years by an independent monitor who will oversee a series of prescribed tests of compliance.[4/] Failure to meet established metrics of compliance is subject to remedy by the United States District Court for the District of Columbia, including through monetary penalties and non-monetary equitable relief.

Lessons Learned

The Program's mortgage servicer investigations and litigation has been the most comprehensive, intensive and coordinated enforcement project in the USTP's history. Although there is still plenty of work to do in terms of ensuring compliance with the settlement agreement by the servicers, as well as ongoing oversight of mortgage servicers in bankruptcy, it is appropriate for the Program to reflect a bit on its experience and consider lessons learned that will guide future priorities. Initially, at least, the Program will be guided by the following observations:

- The USTP must remain agile and adopt enforcement priorities according to the emerging needs in the bankruptcy system. Traditionally, the USTP has carried out significant consumer protection activities, but the misconduct of the mortgage servicer industry required a reordering of priorities. The Program needs to be attuned to developments in the bankruptcy system and adjust its priorities to address areas where we can add the most value to the system.

- The USTP must attack emerging problems by following the evidence wherever it leads, even if the facts are surprising and contrary to prevailing wisdom. Most of us had no notion that a financial institution's record-keeping could be so chronically and systematically inadequate. Material misstatements by debtors are not acceptable and neither are material misstatements by creditors, including national mortgage servicers.

- The USTP can effectively leverage its field-based operations to coordinate a response to multi-district problems. National problems are best resolved through nationwide solutions. By adopting national priorities and focusing offices throughout the country on common issues, the USTP can efficiently acquire and share information that leads to comprehensive results. This settlement is the fourth nationwide settlement obtained by the USTP in the past three years, and it suggests that comprehensive settlements may be an advisable approach for future enforcement initiatives.

[4/] Joseph A. Smith, Jr., has been selected as the monitor. Mr. Smith has served as the North Carolina Commissioner of Banks, and is a former chair of the Conference of State Banks Supervisors.

Conclusion

Not only does this settlement provide relief to homeowners, but importantly it establishes standards to help prevent future misconduct. The USTP is proud of the critical role it played in unraveling the mortgage servicers' abuse of the law and in imposing a new set of uniform practices to be followed. The Program will continue to be vigilant in identifying violations by debtors and creditors alike and will leverage the work of its field offices throughout the country to address systemic violations and to solve industry-wide or multi-district misconduct.