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Deciphering Mortgage Proofs of Claim

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Most chapter 13 bankruptcy debtors are homeowners, and many of these homeowners are in default on their mortgage obligations when they seek bankruptcy relief. Sections 1322(b)(5) and 1322(c)(1) provide these homeowners with the opportunity to cure defaults on home mortgage loans by paying, in full, any pre-petition arrearage amounts. Arrearage amounts consist of any missed regular payments, missed escrow account payments, unpaid late fees and other default charges, if permitted under the note.

Mortgage creditors who wish to receive distributions from the chapter 13 trustee must file a proof of claim. Chapter 13 trustees pay the mortgage creditors any arrearage amounts that are established through the claims process.¹ A properly executed and timely proof of claim constitutes prima facie evidence of the validity and the amount of the claim.² Creditors that file claims are required to use Official Form 10 or a substantially similar document. Form 10 directs creditors to attach an itemized statement if their claim "includes interest or other charges" in addition to the principal amount. This requirement will apply to nearly all residential mortgage claims. Federal Rule of Bankruptcy Procedure 3001 imposes two additional evidentiary requirements for proofs of claim: a copy of the writing, if one evidences the claim, and evidence of perfection, if the creditor asserts a security interest in the property of the debtor. Applied to residential mortgage transactions, Rule 3001 requires the creditor to support its claim with copies of the promissory

¹ In addition, over half of chapter 13 trustees also pay the ongoing mortgage payments (often called "conduit" districts).

² Fed. R. Bankr. P. 3001(f).

About the Author

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Tara Twomey

note and the mortgage or deed of trust.

This trio of documentation (itemization, note and mortgage) permits all parties in a bankruptcy case—debtor, trustee, other creditors and courts—to ensure the accuracy and legality of the claim.³ Without this documentation, it is nearly impossible to verify that the claim is correctly calculated and that it only reflects amounts due under the terms of the note and mortgage and permitted by applicable law. Even when these documents are provided, however, deciphering mortgage claims can still be challenging. The information below is intended to help unravel the mysteries of mortgage proofs of claim.

Mystery #1: Who Is the Creditor?

In today's mortgage market, the identity of the mortgage creditor is not always apparent.⁴ Most mortgages are sold or otherwise transferred to another entity shortly after origination. As a

³ In a recent national study of mortgage claims in bankruptcy more than 50 percent of all claims filed by mortgagees were missing one or more of these documents. See Katherine M. Porter, "Misbehavior and Mistake in Bankruptcy Mortgage Claims," 87 Tex. L. Rev. __ (forthcoming 2008).

⁴ See *In re Hayes*, 2008 WL 3870820 (Bankr. D. Mass. 2008) ("The mortgage lender, its affiliates, assignees, and agents involved in this case, through the convoluted process of securitization, the submission of a 191-page, incomplete pooling and servicing agreement, and reliance upon back-dated, unrecorded assignments, have confounded the identity of the current holder of the mortgage."). See also *In re Nosek*, 386 B.R. 374 (Bankr. D. Mass. 2008), rev'd, unpublished (1st Cir. Ct. 3, 2008).

result, the mortgage creditor is typically not the entity listed on the note or mortgage. A majority of residential loans are securitized, which involves the pooling of mortgage loans, transferring those obligations to a trust and then selling fractional interests in the trust's pool of mortgages to investors.

The right to service mortgage loans may be sold or transferred independently of the loans themselves. Commonly, the originating lender retains the servicing rights when it sells a mortgage loan. Such a lender would be considered both the originator and servicer, but not the current creditor or holder of the loan. In these situations, borrowers may never know that the ownership of their mortgage loans has changed.⁵ The following section describes the key players in residential mortgages transactions. Understanding the role of each player will assist counsel and courts in distinguishing the actual mortgage creditor from its agents and may expedite the resolution of standing and other claims issues.

Mortgage Loan Originator: The mortgage loan originator is the entity whose name appears as the lender on the loan note and mortgage.⁶

Mortgage Loan Holder: The mortgage holder is the entity that currently holds the borrower's note. This party has the present right to receive payments on the note and to foreclose and should be listed as the "creditor" on the proof of claim. If the loan has been securitized, the holder should be the trustee of the trust of the pooled loans (e.g., Deutsche Bank National Trust Company as Trustee for

⁵ While the Real Estate Settlement Procedures Act requires that borrowers be notified when their loan servicer changes, no law requires disclosure to the borrower when a mortgage loan has been sold. However, the Truth In Lending Act requires the loan servicer, upon inquiry, to tell the borrower the identity of the holder of the mortgage. 15 U.S.C. §1641(f).

⁶ For some loans, the Mortgage Electronic Registration System (MERS) appears as the mortgagee of record or beneficiary of the deed of trust as "nominee" for the loan originator.

continued on page 52

Deciphering Mortgage Proofs of Claim

from cover

the MLMI Trust Series 2005-SL1).

Mortgage Servicer: The servicer collects the monthly payments from homeowners and interacts with homeowners on the holder's behalf. It also holds funds in escrow to pay property taxes and homeowner's insurance and remits these payments to the appropriate entities.

Securitized loan pools may have several layers of servicers. For example, the primary servicer will collect monthly payments and interact with the homeowner; the special servicer is often responsible for loans in default and managing properties that have been foreclosed upon; and the master servicer oversees both the primary and special servicer, ensures a smooth transition between the two servicers when a transfer is necessary and is charged overall with protecting the interest of the investors.

In consumer bankruptcies, servicers often file the proof of claim on behalf of the holder.⁷ On the proof of claim, the holder of the mortgage loan should be listed as the creditor and the servicer should indicate that it is acting as agent for the creditor.

Mortgage Electronic Registration System (MERS): MERS is an electronic registry and clearinghouse established by the lending industry to track ownership and servicing rights in mortgages. MERS was developed to reduce the costs associated with the recordation of assignments.

Sometimes MERS is designated the original mortgagee of record as the "nominee" for the originator. Other times the mortgage is assigned to MERS after the loan has closed. Once MERS is the mortgagee of record, all subsequent assignments will not be recorded in the public records. Instead MERS will internally track all the changes in ownership and servicing rights. Borrowers can learn who services their loans from MERS, but MERS generally will not disclose the name of the holder. Because MERS generally has no legal or beneficial interest in the note, courts have differed on whether MERS may prosecute a foreclosure or pursue a motion for relief

⁷ A creditor is the person, corporation or other entity owed a debt by the debtor. See 11 U.S.C. §101(10). Rule 3001(b) permits an authorized agent of the creditor to execute a proof of claim.

from stay solely as "nominee" for the holder.⁸

Mystery #2: How Much Is Owed?

Although the purpose of a proof of claim is to establish the amount of the debt, many mortgagees' claims are hard to decipher. Accurate and complete proofs of claim should provide both a calculation of the total debt and a breakdown of the pre-petition arrearages. Many of the line items in the total debt and arrearage itemizations will be the same. As part of a national empirical study of chapter 13 homeowners and bankruptcy, data was collected on how frequently certain fees and costs appeared in the mortgagees' proofs of claim.⁹ The chart below shows that nearly two-thirds of homeowners had outstanding late fees at the time they filed bankruptcy. In addition, seventy-one percent of cases included default related fees such as foreclosure costs (44 percent), property inspection fees (35 percent), and BPO or appraisals (24 percent). Nearly a third of claims contained fees for post-petition bankruptcy fees such as fees for filing proofs of claim or reviewing chapter 13 plans.

The following is a glossary of terms commonly found on proofs of claim filed by mortgagees.

Total Debt: Entire amount of the creditor's claim at the time of the petition. The amount includes the outstanding principal, accrued interest, escrow deficiencies, late fees and any other charges to the account. Thus, total debt includes within it the pre-petition arrearage amount. This amount should be listed as the "Amount of Claim on Date Case Filed" (Box 1) on Official Form 10.¹⁰ This amount corresponds with the "Amount of Claim without deducting the Value of Collateral" on the debtor's Schedule D.

Arrearage: All past due payments of principal and interest, all past due escrow account payments, and any reasonable costs and fees incurred by the holder and recoverable against the debtor. For

⁸ Compare *In re Huggins*, 357 B.R. 180 (Bankr. D. Mass 2006), with *LaSalle Bank Nat. Ass'n v. Lamy*, 824 N.Y.S.2d 769 (N.Y. Sup. Ct. 2006) (unreported table decision).

⁹ The data shown in the chart comes from the Mortgage Study, an empirical study of over 1700 chapter 13 bankruptcy cases filed by homeowners in 2006. For a complete description of the study's methodology, see Porter, "Misbehavior and Mistake," *supra* note 3.

¹⁰ See Official Form 10 (12/08).

secured mortgage loans, the arrearage amount is indicated as the "Amount of arrearage and other charges as of time case filed included in secured claim, if any" (Box 4) on Official Form 10.

Principal: The sum of money outstanding on the mortgage loan and upon which interest is payable. In many cases the principal amount of the loan will be less than the original amount of the note because some portion of the borrower's monthly payments have been applied to the principal. There are, however, some types of loans, such as interest-only loans and option adjustable-rate mortgages, for which the principal balance at the time of bankruptcy can exceed the original note amount due to negative amortization.

Accrued Interest: Interest earned for the period of time that has elapsed since interest was last paid.

Escrow Payments/Advances /Shortage/Deficiencies: Terms used, often incorrectly, to describe insufficient funds in an escrow account or the disbursement of money for taxes and insurance for loans without escrow accounts. The creditor's claim should include any missed prepetition escrow payments for loans with established escrow accounts.¹¹ Often the number of missed escrow payments is equal to the number of missed principal and interest payments.

Servicers will frequently use the terms "escrow deficiency" or "escrow shortage" on proofs of claim. The two terms have distinct meaning under the Real Estate Settlement Procedures Act, and neither is equivalent to the missed prepetition escrow payments.¹² A deficiency may appear in the total debt section of the claim but not in the arrearage amount itemization because escrow amounts are already accounted for in the missed monthly payments. It is also possible, though less common, for the debtor to have an escrow surplus, which should be indicated as a negative number on the proof of claim.

For mortgage loans without escrow

¹¹ *Campbell v. Countrywide Home Loans Inc.*, 2008 WL 3906382 (5th Cir. Tex. 2008)(debtor's escrow payments that were due prepetition were part of creditor's claim).

¹² Regulation X defines a deficiency as the "amount of a negative balance in an escrow account." 24 C.F.R. §3500.17(b). A "shortage" is defined as an "amount by which a current escrow account balance falls short of the target balance at the time of the escrow analysis." 24 C.F.R. §3500.17(b). A debtor with an escrow shortage will still have a positive balance in their escrow account.

accounts,¹³ this amount usually represents actual disbursements made on the debtor's behalf for taxes, insurance, etc.

Suspense Balance (Unapplied Funds): A catch-all account used to temporarily hold funds that are in "suspense" until the servicer makes a decision on how to permanently allocate or apply them. Payments received from debtors that are for less than the full amount are often put in suspense accounts. Suspense accounts must be authorized by the underlying mortgage documents. The suspense balance should appear as a negative number on the proof of claim and should be subtracted from the total amount due. In bankruptcy cases, servicers may also create a trustee suspense account where payments from the trustee are held prior to being applied to the borrower's account.

Late Charge: A fee charged to borrower's account when the monthly payment is made after the due date. The amount of the late charge is specified in the promissory note.¹⁴ For some loans, the late charge will be a percentage of the principal and interest payment (e.g., 5-10 percent), and in other cases the late charge may be a flat fee (e.g., \$35).

Appraisal: An estimate of the value of property made by a qualified professional appraiser. Appraisals can vary in price depending on whether it contains a full report with a market analysis involving comparable sales and a walk-through of the property or a simple "drive-by" assessment of the property. Full appraisals for residential property generally range from \$350-\$550.

Broker's Price Opinion (BPO): An evaluation of property value typically based on drive-by exterior examination, public data sources and recent comparable sales. As an alternative to a full appraisal, servicers commonly obtain BPOs after the loan is placed in default status or upon loan modification. BPOs typically range in price from \$50 to \$125. While the standard mortgage loan documents generally permit lenders to recover costs of BPOs, courts have questioned the reasonableness and necessity of multiple BPOs when there is no

evidence of any change in circumstances between them.¹⁵

Property Inspection Fee: A fee charged to the borrower for inspections (usually drive-by) to determine the physical condition or occupancy status of mortgage property. Borrowers are typically charged \$8-\$15 per inspection. Often these fees are imposed repeatedly once the account is placed in default status because they are automatically ordered by a servicer's software system. Some courts have found that such inspections are neither reasonable nor necessary or that such inspections without advance notice to the borrower do not comply with the underlying mortgage loan contract.¹⁶ Property inspection fees are distinguishable from property protection costs incurred to preserve the value of the property (e.g., repairing locks, boarding up broken windows).

Foreclosure Costs/Fees: Disbursement for attorney fees and other costs (e.g., publication, sheriff's costs, filing fees, service of process, etc.) associated with collection or foreclosure. A reasonable amount for foreclosure costs and fees will vary dramatically depending on the stage of foreclosure the property was in at the time the homeowner filed for bankruptcy. Foreclosure costs and fees also vary depending on whether a state is a judicial or nonjudicial foreclosure state and on state law itself. Generally, foreclosure fees and costs must be reasonable and actually incurred before they are recoverable against the borrower.¹⁷

Bankruptcy Fee: A postpetition, preconfirmation fee charged by the servicer if the borrower files a bankruptcy. This is often a flat fee listed on the proof of claim filed or added to the borrower's account as a recoverable expense or corporate advance. These fees may also be called POC Fees, Bankruptcy Monitoring Fees or Plan Review Fees. The range for these fees is \$150-\$550. Courts have differed on whether such fees are recoverable by the servicer.¹⁸ When such fees are

recoverable, some courts require servicers to file Rule 2016 disclosures.¹⁹ Other courts permit such fees to be included on the proof of claim so long as it is sufficiently detailed.²⁰

Force Placed Insurance: Hazard insurance purchased by servicer on borrower's home (typically covering only lender's interest) when policy purchased directly by borrower on nonescrow mortgage account has lapsed or when servicer contends that borrower has failed to provide proof of insurance coverage.

Corporate Advance: Disbursement for servicing-related expenses (not escrow expenses) paid with servicer funds and to be recovered from the borrower. Corporate advances may include foreclosure expenses, attorney fees, bankruptcy fees, force placed insurance and so forth. Corporate advance amounts should be itemized so that the debtor, trustee and court can determine whether such fees are appropriate and can ensure amounts have not been double-charged.

Statutory Expense: Any tax, special assessment or other charge imposed by federal, state or local taxing authority or other governmental entity. Generally does not refer to taxes paid through escrow account but rather corporate advances to cover such charges when account is in default, a tax sale is pending or after a foreclosure sale is completed.

Payoff Fee: A fee charged to borrower for providing statement of amount required to pay off loan.

Fax fee: A fee charged to borrower for faxing a payoff statement or other information to the borrower. Other similar fees may include e-mail fees and overnight delivery fees. As with other fees charged to the debtor's account, these fees must be reasonable under the circumstances.

function not requiring attorney), with *In re Moye*, 385 B.R. 885 (Bankr. S.D. Tex. 2008) (allowing \$200 fee for preparation of proof of claim), and *In re Conde-Dedonato*, 391 B.R. 247 (Bankr. E.D.N.Y. 2008) (permitting creditor to recover \$200 plan review fee and \$150 proof of claim fee).

¹⁹ See, e.g., *In re Sanchez*, 372 B.R. 289 (Bankr. S.D. Tex. 2007) (post-petition, pre-confirmation fees disallowed where creditor failed to disclose fees and file Rule 2016 applications). See also *In re Hight*, 2008 WL 3539802 (Bankr. S.D. Tex. Aug. 13, 2008) (court unable to determine reasonableness of prepetition foreclosure fees because creditor failed to present evidence describing "what work was done, who did the work, what that person's hourly rate is, or how much time was spent doing the work").

²⁰ See *In re Atwood*, 293 B.R. 227 (B.A.P. 9th Cir. 2003) (proof of claim lacking specific detail fails to meet creditor's evidentiary burden on reasonableness of fees).

¹⁵ See *In re Stewart*, 391 B.R. 327 (Bankr. E.D. La. 2008) (disallowing fees for BPOs that were duplicative, that were allegedly conducted while location of property was under evacuation order, or that were allegedly conducted after property was sold at foreclosure).

¹⁶ See *In re Stewart*, 391 B.R. 327 (Bankr. E.D. La. 2008) (finding that automatically generated property inspections conducted on wrong property, and even when conducted on correct property, were never reviewed by servicer).

¹⁷ See *Korea First Bank v. Lee*, 14 F. Supp. 2d 530 (S.D.N.Y. 1998) (lender not entitled to recover more than it paid its attorney or more than what was reasonable).

¹⁸ Compare *In re Marks*, 2005 WL 4799326 (Bankr. W.D. La. Nov. 30, 2005) (disallowing proof of claim fee because it was administrative

¹³ The term "escrow advance" or "escrow deficiency" is a misnomer when applied to loans that do not have an established escrow account. These expenses are more properly described as insurance or tax advances.

¹⁴ If a copy of the promissory note is not attached to the proof of claim as required by Rule 3001, it will be difficult, if not impossible, to determine whether the amount of late fees are correct.

