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QUARTERLY

Q3 2014 COMMITTED TO THE INDUSTRY, INTEGRITY, AND BEST PRACTICES

National

Operation Mis-Modification: *CFPB, FTC, and States Crack Down on Mortgage Relief Scams*

By: Jaclyn Hilderbrand—Codilis & Associates, P.C.

Since the downturn of the housing market, we often read articles about homeowners being scammed by mortgage assistance relief services (MARS) companies. MARS companies guarantee homeowners that they will secure a loan modification, reduce their principal balance, or lower their interest rate. Some companies even make the elusive "free home" promise. Based on these deceitful claims, distressed homeowners have invested millions with nothing to show for it. In many cases, the homes of those who sought help and paid for these relief services have ultimately been foreclosed.

These companies negatively affect the public's opinion of the default servicing industry by advertising false relationships with banks. Not only do the companies promise loan modifications, but they give homeowners the false impression that they will provide legal representation. Attorneys are spearheading the schemes and advertise legal help in states where they are unauthorized to practice.

Government Action

In an effort to shut down fraudulent MARS operations and recover money for homeowners, the government is taking action with Operation Mis-Modification. On July 23, the Consumer Financial Protection Bureau (CFPB), the Federal Trade Commission (FTC), and 15 states announced 41 lawsuits filed nationwide against companies that engaged in MARS schemes. The FTC filed six complaints alleging misrepresentations and deceptive omissions of material fact in violation of Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), and the MARS Rule, 16 C.F.R. 322, re-codified Regulation O, 12 C.F.R. 1015. The CFPB filed three complaints alleging similar violations of

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National

MERS: Is the Crisis Over?

By: Kristin Schuler-Hintz and Melissa Robbins Coutts—McCarthy & Holthus, LLP

Mortgage Electronic Registration Systems, Inc., aka MERS, was originally created in 1995 to improve the mortgage/deed of trust process by permitting the electronic tracking of security interests and eliminate the need to record an assignment each time a promissory note and security instrument transferred. From the initial creation of MERS through the housing boom, MERS was an unremarkable entity, known only to the housing industry. But all that changed in 2007 when the housing bubble burst and parties who had been relying on continuously rising home equity watched their dreams crumble as equity plummeted and jobs disappeared. Lawsuits sprung up by the thousands, challenging the MERS system on four primary theories:

(1) the note and security instrument were unenforceable due to having been split;
(2) MERS lacked signing authority;
(3) MERS cannot be a beneficiary or mortgagee; and
(4) the MERS system deprives local government of fees and/or taxes.

Courts across the country struggled with these issues, reaching largely disparate

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National

Employee Engagement = Improved Profitability

By: Jan Duke—Firm Solutions

Obtaining profitability—or retaining profitability—is a challenge that many default firms are facing in today's environment. The challenge has become greater in recent years due to the increased cost of compliance, reduced overall volume of foreclosures, and consolidation efforts of servicers to reduce their number of firms. Many factors contribute to profitability, including streamlined processes and effective accounting and billing practices. However, long-term financial success is rooted only in world-class management systems. A key component of profitable management practices is fostering a workplace setting that engages employees, resulting in an attitude of caring and commitment about the success of "their firm." Engagement has a direct correlation to company profitability. Typically, compensation and benefits is but one of the top drivers of employee engagement. Employees are highly motivated by work relationships, positive work environments, sense of community within their workplace, and the capacity provided by the workplace setting to deploy their skills and talent as part of their daily job.

According to the Society for Human Resource Management (SHRM), a fully engaged performer has enthusiasm and interest in his or her job, which has a direct and positive impact on the level of effort put forth in job performance, and results in improved quality of product or service innovations. Engaged performers show an increased use of intelligence (cognitive, emotional, physical dexterity) to complete tasks and "build new products and services, generate new ideas, create new customers, and ultimately help spur the economy to create more good jobs." Engagement's effects include increased job satisfaction, customer service, job performance, and commitment; decreased absences and turnover; and presence of high group morale, organization, and bond.

"Employee Engagement" continued on page 23

A FAST-CHANGING ENVIRONMENT KEEPS GETTING FASTER

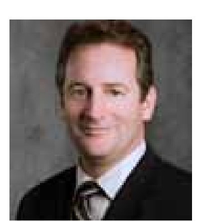
Greetings! For those of us who have been in the industry for a while, each successive year has seemed more intense than the last for quite some time. Foreclosure volumes rose throughout the last half of the previous decade. Then the "robo-signing" issue and its aftermath had a profound effect on the industry in 2010 and after. Recently, we have experienced the onset of a new regulatory environment in which compliance is king, accompanied by higher risk of liability coupled with falling default rates.

In many ways, those of us who have faced and met these challenges—and continue to do so—are fortunate. It has been a profound experience, and we have played a substantial and consequential role during a critical economic upheaval that will shape the economy for decades to come.

It was for this reason that I considered it a privilege to chair the Legal League 100 Education Committee for the past year. For anyone who is stimulated by the issues and challenges that confront our industry, this has been an ideal year to help formulate the agenda discussion. As the current issue of this publication shows, we continue to have much to consider.

The Fall Legal League 100 Servicer Summit will therefore once again be a lively forum, much like this current issue of Legal League Quarterly. While we will discuss familiar topics that remain current, such as the state of our industry and legislative and case law updates, we will also have many new issues to tackle, like the financial pressures of compliance. We will discuss regulatory developments and how the new regulations are being implemented and enforced, and so much more.

It is sure to be an informative gathering as well as an exciting discussion because we continue to live in an exciting time. As you read the latest developments in this current issue, I would ask you to consider what is currently affecting your side of the industry and, please, bring your thoughts and reflections to the Fall Legal League 100 Servicer Summit.



DOUGLAS A. OLIVER
FREEDMAN ANSELMO LINDBERG LLC
Education Subcommittee–Legal League 100

Douglas A. Oliver joined FAL in 2005 as associate counsel and was later appointed managing attorney of the litigation practice group. Most recently, in July 2013, Mr. Oliver was named Partner to the firm. He practices in the areas of mortgage foreclosure, collections and real estate law. Mr. Oliver, an experienced trial lawyer, focuses mainly on contested foreclosure and collection matters.

Mr. Oliver is a graduate of Drake Law School (1993, with honors) and is licensed to practice in the state and federal courts of Illinois. Mr. Oliver is experienced in trial of foreclosure matters and has successfully litigated numerous issues relative to such legal terrain as the Illinois Mortgage Foreclosure Law, the federal Truth in Lending Act, the Illinois Consumer Fraud Act and the federal Real Estate Settlement Procedures Act within the context of mortgage foreclosure.

Mr. Oliver serves as the chair of the Legal League 100 Education Subcommittee, and is also a frequent presenter at various industry conferences, seminars, and trade association groups. Most recently, he was asked to be a panelist at the Mortgage Bankers Association Conference in Dallas, Texas in February 2013.

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Exploring the CFPB's New Rules

By: Jennifer Lima-Smith—Gilbert Garcia Group, P.A.

As of January 10, the Consumer Financial Protection Bureau (CFPB) implemented new rules, with more to come during 2015. In January 2013, the CFPB issued eight final rules concerning mortgage markets, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. See Public Law 111-203, 124 Stat. 1376 (2010) (Title XIV Final Rules), which became effective this year.

The rules amended Regulation X, which implemented the Real Estate Settlement Procedures Act of 1974 (RESPA) and provided interpretation to Regulation X found at 12 CFR section 1024. The rules amended Regulation Z found at 12 CFR section 1026. This article addresses some of the new rules and recommends a course of action in judicial foreclosure states like Florida.

The most important change prohibits "dual tracking." Servicers must follow specific loss mitigation procedures for a mortgage loan secured by a borrower's principal residence. Servicers used to simultaneously evaluate a consumer for modification or other alternatives while proceeding with foreclosure. Now, a servicer may not make the first required filing in a suit until the borrower is more than 120 days delinquent.

Federal Preemption

Everyone's asking: Can Congress, by federal law, require states to abate foreclosure proceedings for purposes of evaluation of loss mitigation options?

In Florida, the answer is yes: Preemption may be either express or implied and "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 95 (1983), as cited in Vreeland v. Ferrer, 71 So.3d 70, 75 (Fla. 2011). The federal preemption directive does extend to state laws and compels courts to act in compliance with the federal law. Vreeland, 71 So.3d at 84–85.

Implementation – Regulation X and Regulation Z

If a borrower submits a complete loss mitigation application before the servicer has made the first filing, a servicer may not start the foreclosure process unless:

The servicer informs the borrower that he/she is not eligible for any loss mitigation option (and any appeal has been exhausted);

The borrower rejects all loss mitigation offers; or

A borrower doesn't comply with terms of loss mitigation.

Loss Mitigation Efforts

If a borrower submits a complete application for a loss mitigation option after the first foreclosure filing, but more than 37 days before a foreclosure sale, a servicer is prohibited from moving for judgment, ordering a sale, or conducting a sale until one of the conditions mentioned above is satisfied. The servicer must instruct counsel not to proceed with any action in preparation to foreclose on the property. The servicer must evaluate the borrower, within 30 days, for all eligible loss mitigation options and provide a detailed written decision if denying the request.

A lender must acknowledge receipt of the application in writing within five days. The acknowledgment must state whether the application is complete and, if not, what information is needed for completion. The rules also require a single point of contact (SPOC) to facilitate communication between the borrower(s) and the lender/servicer.

A servicer may proceed with foreclosure, including any publication, arbitration, or mediation requirements established by applicable law, when the first notice or filing for a foreclosure proceeding occurred before receipt of a complete loss mitigation application so long as it doesn't result in the issuance of a foreclosure judgment, order of sale, or the conducting of a sale.

> *"Servicers must follow specific loss mitigation procedures for a mortgage loan secured by a borrower's principal residence. Servicers used to simultaneously evaluate a consumer for modification or other alternatives while proceeding with foreclosure."*

A borrower may appeal denial of a modification. The servicer, within 30 days, shall provide notice stating whether the servicer will offer the borrower a loss mitigation option and how long the borrower has to accept or reject the offer or a prior offer of a loss mitigation option. The borrower may be required to accept or reject an offer no earlier than 14 days after the servicer provides the notice to a borrower.

Recent rules defining Regulation Z amend the scope, timing, content, and format of adjustable-rate mortgage notices and require periodic statements be timely sent.

Error Resolution Notice and Response

New rules affecting error resolution and acknowledgements have certain time frames. There are nine categories (including payoffs, service transfers, payments, fees, loss mitigation, impounds, and "any other error relating to the servicing of a borrower's mortgage loan") where error resolution notice is required. Written acknowledgement to the borrower is due within five days and a more substantive response is due in 30 days. See 12 CFR 1024.35(d) and 12 CFR 1024.35 (e). Payoff balance errors require a response within seven days.

Private Right of Action

The CFPB rule allows for a private right of action regarding loss mitigation evaluation and dual tracking prohibitions. Legal actions and counterclaims alleging violation of CFPB regulations are likely. Exactly how this will play out still remains to be seen.

TILA-RESPA, Integrated Disclosures, and Closings

"The spirit of TILA-RESPA is about fairness, education, and transparency for the consumer. The creditor must take the steps necessary to have a consumer show up to the closing table with confidence that they understand everything on the Loan Estimate. With all of the dynamics in the loan origination process, it is clear the best practice must leverage technology to empower the consumer with education, fairness, and transparency as well as document-specific actions of the creditor, mortgage broker, title agent, and consumer." HousingWire, article posted July 9.

Does the consumer know what APR means? Does the consumer understand that the information they provide on the form results in an application? Does the consumer understand all of the components prior to their intent to proceed? Can you prove that the borrower read the form and understood it?

The Loan Estimate form is designed to provide helpful disclosures to consumers in understanding key features, costs, and risks of the mortgage loan. They must be given to the consumer no later than the third business day after submission of the loan application. Additional fees cannot be charged before the consumer has received the Loan Estimate. There are definitions for changed circumstances. A loan disclosure may not be revised on or after the date the creditor provides the closing disclosure. Simply put, the Loan Estimate must contain a good faith estimate of credit costs and transaction terms.

The Closing Disclosure form must be provided to the consumer at least three business days before the closing on the loan. The term "business day" has recently been interpreted to mean all calendar days except Sundays and the legal public holidays specified in 5 U.S.C. 6103 (a). This form is designed to help borrowers in understanding all of the costs of the transaction. This would include information such as the interest rate, monthly payments, recording costs, and the cost to close on the loan.

This rule doesn't apply to home equity lines of credit (HELOCs), reverse mortgages, or mortgages secured by a mobile home or a dwelling that is not attached to real property (land).

The rules impose requirements for records retention and set forth schedules for keeping and maintaining origination documents, with two-, three-, and five-year requirements. According to the CFPB guide, the forms are not to be used before August 1, 2015.

Resolution of time-sensitive litigation can be completed with the proper aid of foreclosure counsel. Best practices include solid communication with counsel; certification of the status of loss mitigation efforts prior to judgment and sale; no dual tracking; and review of the history of details, referrals, and transfers.

Additional information may be found at: www.consumerfinance.gov/regulatory-implementation

Sixth Circuit Decision Impacts Absolute Priority Rule in Chapter 11 Cases

By: Melissa Byrd—Trott & Trott, P.C.

The requirements for a debtor to confirm a Chapter 11 plan of reorganization are found in 11 U.S.C. § 1129(a). One such requirement is each impaired class of creditors accepting the plan. However, a debtor may confirm a plan that does not comply with § 1129(a)(8)(A) by using a "cram down" provision "if the plan does not discriminate unfairly, and is fair and equitable" to the creditors who have not voted to accept the plan. Under § 1129(b)(2), the requirements for a plan to be considered "fair and equitable" are laid out, which include satisfaction of the "absolute priority rule" found in § 1129(b)(2)(B)(ii), which states in relevant part:

For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(B) with respect to a class of unsecured claims—

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

§ 1129(b)(2)(B)(ii) (emphasis added). The absolute priority rule mandates that, prior to the debtor retaining any property under the plan, every unsecured creditor must be paid in full.

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, the absolute priority rule applied to individual debtors in a Chapter 11. With the addition of the italicized portion, above, there have been opposing viewpoints regarding whether the rule still applies to individual debtors. The legal argument has primarily centered on the phrase "the debtor may retain property included in the estate under section 1115[.]"

A recent opinion by the Sixth Circuit held that "the absolute priority rule continues to apply to pre-petition property of individual debtors in Chapter 11 cases." Ice House Am., LLC, v. Cardin, 2014 U.S. App. LEXIS 8882 at *13 (6th Cir. 2014). In Ice House Am.v. Cardin, Debtor, Charles Cardin, and Creditor, Ice House American, LLC, agreed that the absolute priority rule was not satisfied under the Debtor's proposed plan. The Debtor's bankruptcy schedules showed assets that included over-secured collateral. The Debtor's plan allowed him to retain these assets, while the Debtor's plan paid Creditor's claim of $1.545 million only $124,000, plus any disposable income the Debtor earned during the plan's five-year term. Both Creditor and the United States Trustee objected to the plan, reasoning that it violated the absolute priority rule. The Bankruptcy Court overruled the objections, interpreting the new language in the Code to abolish the absolute priority rule in cases filed by individual debtors in Chapter 11. The Bankruptcy Court confirmed the Debtor's plan. The Creditor appealed to the District Court. The District Court certified the question presented for direct appeal to the Sixth Circuit, which granted permission for the appeal. Ice House Am.v. Cardin, at *5.

The Creditor and the Debtor agreed that the italicized language in question does formulate an exception to the absolute priority rule that applies to individual Chapter 11 debtors. Ice House Am.v. Cardin, at *7–*8. However, their arguments differed in that the Creditor argued that the italicized language excepts from the absolute priority rule only post-petition property added by § 1115. The Debtor and the Bankruptcy Court agreed that the italicized language excepts not just post-petition property, but also all property of the estate under § 541, which would render the absolute priority rule inapplicable to individual debtors as a whole. Id., at *8-*9.

The crux of the Sixth Circuit's decision that the absolute priority rule still applied to individual debtors focused on the word "included" in the italicized portion of the statute. The Sixth Circuit decided that, of its two dictionary definitions for included, the one with the best fit to the situation was "to take in." Ice House Am.v. Cardin, at *8–*9. The Court continued on in its reasoning to find that, by using that definition in place of the word included, "the debtor may retain property that § 1115 takes into the estate." Id. at *9. While § 541 had already brought "all legal or equitable interests of the debtor in property as of the commencement of the case" into the estate, the court found, § 1115 takes into the estate property "that the debtor acquires after the commencement of the case." Id. at *9–*10. "Thus, it is only that property—property acquired after the commencement of the case, rather than property acquired before then—that the "debtor may retain" when his unsecured creditors are not fully paid." Id. at *10, citing 11 U.S.C. § 1129(b)(2)(B)(ii). The Court held that, "the absolute-priority rule continues to apply to pre-petition property of individual debtors in Chapter 11 cases," and therefore reversed the ruling of the Bankruptcy Court, remanding for further proceedings. Id. at *13.

All the other Circuit Courts to have ruled on the issue have found that the absolute priority rule continues to apply to pre-petition property of the individual debtors in Chapter 11 cases, and so the Sixth Circuit joins the Fourth Circuit (In re Maharaj, 681 F.3d 558, 565 [4th Cir. 2012]), Fifth Circuit (In re Lively, 717 F.3d 406, 410 [5th Cir. 2013]), and 10th Circuit (In re Stephens, 704 F.3d. 1279, 1287 [19th Cir. 2013]) in reaching the same interpretation. Ice House Am.v. Cardin, at *13.

Melissa Byrd is a litigation attorney with Trott & Trott, P.C., a Michigan-based real estate finance law firm. She concentrates her practice in the areas of bankruptcy and mortgage creditors' rights. Byrd can be reached at mbyrd@trottlaw.com.

National

Michigan Court of Appeals Holds Voluntary Mergers Do Not Transfer a Mortgage Interest by Operation of Law

By: Paul Poles—Potestivo & Associates, P.C.

In the recently published case Federal Home Loan Mortgage Association v. Kelley, No. 315082, the Michigan Court of Appeals addressed the recordation requirements of MCL § 600.3204(3) with respect to a successor mortgagee obtaining a mortgage by virtue of a voluntary merger. In the June 24 opinion, the court ultimately held that in order to establish the requisite chain of title to conduct a foreclosure by advertisement, an assignment of mortgage must be recorded from the merging entity into the surviving entity prior to the date of sale.

In 2003, the defendants in Kelley obtained a loan in the amount of $240,000 to purchase real property located in East Lansing, Michigan. The loan was secured by a mortgage on the property. The mortgage was subsequently assigned from the originator to ABN-AMRO Mortgage Group, Inc. ("ABN-AMRO") and the assignment was properly recorded in late 2003. In 2007, CitiMortgage, Inc. ("CMI"), and ABN-AMRO merged. CMI was the surviving entity. In 2011, the defendants defaulted on the mortgage and CMI conducted a foreclosure by advertisement pursuant to MCL §§ 600.3201, et seq. Federal Home Loan Mortgage Association ("Freddie Mac") purchased the property at a sheriff's sale and the defendants failed to redeem.

Following the expiration of the statutory redemption period, Freddie Mac initiated eviction proceedings. The Kelley defendants contested the eviction alleging, in part, that there was a violation of MCL § 600.3204(3) because the chain of title lacked an assignment of mortgage to CMI. However, the district court rejected the defendants' argument. In doing so, the district court sided with Freddie Mac, which argued that mortgages acquired as the result of a merger are, ipso facto, obtained by operation of law—thereby eliminating the need for a recorded assignment of mortgage. A sequence of appeals followed shortly thereafter.

Ultimately, the Michigan Court of Appeals held that the merger between ABN-AMRO and CMI did not result in CMI acquiring the mortgage by operation of law. In doing so, the court relied on the operation of law designation set forth by the Michigan Supreme Court in Kim v. JP Morgan Chase Bank, N.A., 493 Mich 98 (2012). Focusing on the fact CMI voluntary entered into a merger agreement with ABN-AMRO, the court held the mortgage was not passed to CMI "unintentionally, involuntarily, or through no affirmative act of the transferee." 1 In rejecting Freddie Mac's arguments to the contrary, the court reasoned that Kim's discussion of mergers focused on those initiated by the FDIC under 12 U.S.C. § 1821 as opposed to mergers in general. As a result of the foregoing analysis, the court held that in order to comply with MCL § 600.3204(3), a recorded assignment of mortgage from ABN-AMRO to CMI was required.

However, despite the lack of assignment from ABN-AMRO to CMI, the court further held that the underlying foreclosure was merely voidable, not void ab initio. Relying on Kim once again, the court determined that "because defendants did not allege that the defect amounted to prejudice, they were not entitled to any relief and the district court properly entered an order terminating defendants' possession of the property."

On July 15, Freddie Mac filed a Motion for Reconsideration arguing, in part, that the court in Kelley ignored Michigan statutory2 and case law, which negate the need for an assignment of mortgage in merger situations. Kelley filed an answer on July 29. At the time of publication, there was no decision on the Motion for Reconsideration. Based on the same, the Kelley case and its controversial holding will likely remain on the industry radar for the foreseeable future.

If you have any questions about this case, please contact associate attorney Paul Poles at ppoles@potestivolaw.com or 248.853.4400, ext. 1170.

2 MCL § 450.1724(1)(b)

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Brian A. Flaherty, COO, at 732.232.4341 or brian.flaherty@globalstrategic.com

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855.731.4966

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Misconceptions and Realities of Nonbank Mortgage Servicer Regulation

By: Neal Doherty and Maria Moskver—Walz Group

Over the last several months, non-bank mortgage servicers have experienced increased scrutiny from state and federal regulators. As these special servicers have increased in size, regulators have voiced concerns that they do not have the resources to manage this growth. One specific concern is that nonbank servicers will not be able to keep up with the dynamic regulatory environment facing the industry.

This article will examine the rise in market share by non-bank mortgage servicers, the extent to which these entities are regulated, and the potential sources of future regulatory activity.

Growth of Non-Bank Mortgage Servicers

One of the major factors driving the shift from banks to nonbanks is the new set of capital requirements under the Basel III international banking accords. In the wake of the financial crisis, regulators put in place stronger capital requirements for large banks. Under Basel III, banks will have to limit mortgage servicing assets to 10 percent of a bank's Tier 1 common equity or be penalized for holdings above that limit. This has resulted in a massive transfer of MSRs from banks, which have to comply with these capital requirements, to nonbanks, which are not subject to the same limits. In fact, 2013 was a record-breaking year in terms of MSR sales as banks shed these assets to get under the capital threshold.

Perception Is Regulatory Reality

The perception among state and federal regulators is that non-bank mortgage servicers are less heavily regulated than banks. Whether this perception is accurate or not is up for debate and will be examined later in this article. Unfortunately, however, this is a case of perception becoming reality: As long as the regulators believe that the non-bank servicers are less regulated, that belief will inform their decision-making, drive their policy development, and be reflected in their enforcement activities. The examples of this new reality are numerous.

This increased scrutiny was highlighted in a speech given to the Mortgage Bankers Association (MBA) in May by New York's superintendent of financial services, Benjamin M. Lawsky. After describing the main reason for their increased market share—namely the fact that the large banks were "offloading" MSRs rather than increasing capital to comply with Basel III—Lawsky voiced his concerns that these MSR sales may trigger a race to the regulatory bottom, ultimately putting homeowners at risk.

Lawsky argued that because the compensation paid to mortgage servicers is fixed by contract, the cheaper a servicer can service a mortgage, the more profit it will make. Lawsky is concerned that non-bank servicers will cut compliance costs in order to protect their profit. Lawsky's department investigated several non-bank servicers and found a host of problems, including the inability to produce required documents and information technology issues, which resulted in borrowers not getting information about loan modifications.

Lawsky's concerns are shared by other regulators. For example, the Federal Housing Finance Agency's (FHFA) Office of the Inspector General issued a report on July 1 concerning FHFA's actions to manage Fannie Mae and Freddie Mac's risks from the growth of non-bank servicers. The report noted that of the 30 largest mortgage servicers, non-bank servicers held 17 percent of the mortgage servicing market by the end of 2013, up from 9 percent at the end of 2012.

According to the report, these companies are subject to less stringent regulatory and financial requirements than banks and, as a result, potentially threaten the financial health of the GSEs. The OIG cited several specific risks, most notably the following:

The acquisition of additional MSRs may be beyond what the infrastructures of the non-banks can handle. The OIG report noted that the rise in non-bank servicers has been accompanied by "consumer complaints, lawsuits, and other regulatory actions as the servicers' workload outstrips their processing capacity."

The report recommended that the FHFA issue guidance on a risk management process for non-bank servicers and develop a comprehensive, formal oversight framework to examine and mitigate the risks these servicers pose.

Under-Regulated?

While it's true that non-bank servicers are not subject to the Basel III capital requirements, are they really "under-regulated"? Based on the incredible volume of recent activity by federal and state regulators, the answer would appear to be a resounding "no." Central to any discussion of regulation is the Consumer Financial Protection Bureau (CFPB), which was created four years ago to be the primary federal agency responsible for all consumer protection functions.

In its first four years on the job, the CFPB has moved with breathtaking speed. In just the past year, the CFPB has imposed more than 20 rules specifically relating to the mortgage industry, nearly all of which are applicable to non-bank servicers. Obviously, the most impactful of these regulations are the CFPB's mortgage servicing rules, which went into effect January 10. The directives implemented the mortgage servicing provisions and requirements of Dodd-Frank and established, for the first time, uniform national mortgage servicing standards. All told, the new mortgage servicing rules run to more than 1,150 pages of text, not including numerous amendments, implementation guides, and the like. The new mandates represented a massive regulatory shift which required all industry participants—including non-bank mortgage servicers—to fundamentally change the way they do business.

Following a very short grace period to allow servicers to implement the new requirements, the CFPB's enforcement of the new rules has grown more aggressive. In a now famous speech in front of the MBA in February, CFPB deputy director Steve Antonakes proclaimed that it was a new regulatory morning and that "Groundhog Day" was over. Antonakes noted that the new mortgage servicing rules are now subject to federal supervision and enforcement across the entire marketplace, with the only limitation being the small servicer exemption for those with fewer than 5,000 loans. The clear message was that servicers—banks and non-banks alike—need to comply with the CFPB rules or face examination, enforcement actions, and fines.

The Future Regulatory Environment

It should be unmistakably clear that the CFPB expects all mortgage servicers' houses to be in order—and not just the non-bank servicers, despite the recent public regulatory scrutiny. We believe that this heightened regulatory posture is not going away any time soon, absent some extraordinary political shift on a national level. The CFPB's examinations will continue to highlight and publicize any compliance shortcomings found at targeted institutions. Enforcement actions and large fines will surely follow.

In addition to the CFPB, state regulators are also getting into the act. State officials—typically the attorney general or chief banking regulator—are starting to use power given to them by Dodd-Frank to regulate financial entities. This new development gives state regulators a powerful new tool to use in their consumer protection activities. It has already been utilized in Illinois, Mississippi, and New York, and we expect other state regulators to follow suit.

We believe this current level of regulation will continue in the future and that any regulatory relief will be marginal at best. Widespread regulatory relief is highly unlikely, so it is recommended that all mortgage servicing companies continue to adjust to this new regulatory reality.

CFPB 2013-12 and Lawfully Handling Mortgage Loans of Deceased Borrowers

By: Jason A. Whitacre and Ashley E. Mueller—The Law Offices of John D. Clunk Co., LPA

Unlike other regulatory agencies, which promulgate regulations after notice-and-comment periods, the CFPB typically regulates through enforcement actions and informal guidance bulletins, allowing it to develop its policies at a much faster pace and in more targeted ways. Along that vein, concerned that surviving spouses, children, and other beneficiaries were having extreme difficulty in handling mortgaged properties of the deceased, the CFPB issued Bulletin 2013-12 on October 15, 2013.

This bulletin included new requirements on mortgage servicers upon notification that a borrower is deceased. In particular, the CFPB mandates that servicers have in place policies and procedures "reasonably designed to identify and facilitate communication with successors in interest to deceased borrowers."

> "These considerations also illuminate the intent behind the CFPB guidance: that servicers make individualized decisions on these properties, which may or may not be practical and effective."

Requirements of the Bulletin

Pursuant to the bulletin, these policies and procedures should include steps to achieve a number of desired objectives, including:

When a party claims to be a successor in interest to a deceased borrower, the servicer should promptly provide a list of all documents or other evidence it requires (reasonable in light of the laws of the relevant jurisdiction) to establish both the death of a borrower and the identity, and legal interest, of parties in succession.

When a servicer is notified that a borrower is deceased, it must promptly identify and evaluate certain issues in handling the borrower's loan, including:

- Receipt of acceptable proof of the successor's identity and legal interest in the property;
- Standing of the mortgage loan as current or delinquent;
- Eligibility of the successor to continue making payments;
- Whether a trial modification or other loss mitigation option was in place at the time of the borrower's death;
- Whether there is a pending or planned foreclosure proceeding;
- Eligibility of the successor in interest for loss mitigation options; and
- Eligibility of the successor in interest to assume the mortgage loan.
- The servicer must promptly provide the successor with information about the above issues, including any servicer prerequisites to continue payments, assume the mortgage loan, and qualify for available loss mitigation options.
- The servicer must also promptly provide the successor with any documents, forms, or materials it requires for the successor to continue making payments, apply to assume the mortgage loan, and qualify for available loss mitigation options.
- Further, the servicer must promptly review and evaluate the successor and, where appropriate, implement the options set forth above.
- Finally, the servicer must provide training to its employees regarding the effect of laws and investor/other guidelines/requirements and how to comply with those laws, including:
- Servicing guidelines, including those of Fannie Mae and Freddie Mac;
- The Garn-St. Germain Act of 1982 (regarding the limitations of due-on-sale clauses); and
- Federal or state law restricting the disclosure of the deceased borrower's personal information.

If foreclosure activity is pending, the servicer must also make an actual decision on whether to postpone or withdraw it upon notification of the death of the borrower to allow a successor in interest reasonable time to establish ownership rights and pursue assumption and/or applicable loss mitigation options. The CFPB has placed further obligations on the servicer to provide information to successors in interest about the possible consequences of assuming the loan.

The Bulletin's Practical Impact

Now that we know what the CFPB expects of servicers, assuming the goal of compliance, what impact does that have on the servicing of default mortgages (or those loans in danger of imminent default)? For starters, servicers must be cognizant of all the ways in which they can find out that a homeowner is deceased.

The CFPB does not limit the requirements of Bulletin 2013-12 based upon how the information is received, so servicers and third-party vendors and hired legal professionals must all work together to pass along this information. Servicers must then ensure procedures exist to route that information to the correct personnel.

The death of a borrower can occur before or after a loan default, as well as at different stages of a foreclosure action. A servicer may need detailed and adequate internal procedures to ensure that when a servicer has been made aware that a borrower is deceased, the CFPB's requirements are being met and information properly handled.

Customer service representatives, loss mitigation specialists, and mediation participants are just a few of the multitudes of employees who may end up as gateways for this information. Moreover, hired legal professionals may receive this information while appearing on a servicer's behalf in court-related matters, and third-party vendors performing property inspections may also become aware of the death of a borrower.

Though the CFPB does not, of course, define "reasonably designed," it has set forth the expectation that successors who diligently attempt to contact a servicer within a reasonable amount of time will be afforded some legitimate opportunity to prove their interests in the property and to take necessary steps to protect those interests. Specifically, the CFPB has frowned upon requirements placed upon these successors such as requesting probate documents when a property has already been transferred by survivorship deed.

In addition, pursuant to Regulation Z § 1024.38(b)(1)(vi), once a servicer has been made aware of a borrower's death, it must promptly identify and communicate with any known successors regarding the property. A servicer cannot simply wait for a successor to contact them; Bulletin 2013-12 suggests that the servicer must be proactive in contacting any successors within a reasonable time after notification of the borrower's death.

These considerations also illuminate the intent behind the CFPB guidance: that servicers make individualized decisions on these properties, which may or may not be practical and effective. Though the CFPB does put some burden on the successors to prove their interests, it requires servicers to understand individual state laws on succession, or at least have a process to get that information where it needs to go. For these reasons, the failure to demonstrate some human decision-making on a particular case could doom the servicer in an enforcement lawsuit.

Finally, the ambiguity contained within the bulletin is particularly unhelpful. It requires the disclosure of information to non-borrowers yet admonishes the servicer to be mindful of state and federal laws protecting the deceased's personal information. This creates a minefield through which the servicer must navigate under the constant threat of lawsuit or enforcement action.

All told, Bulletin 2013-12 is an attempt by the CFPB to rectify what it believes is a serious problem facing consumers and their families. And, as the CFPB quickly point outs, it is a federal agency charged with protecting consumers; thus, it will tilt any ambiguities in favor of resolving these problems for consumers whether real or perceived. Servicers and others in the industry would do well to err on the side of caution if they intend to avoid CFPB enforcement through compliance.

Jason Whitacre and Ashley Mueller serve as attorneys for the Law Offices of John D. Clunk Co., LPA. The JDC Family of Companies assists lenders and servicers in Ohio, Kentucky, and Florida. Contact Whitacre at jwhitacre@johndclunk.com with any questions.

Surviving the Lows

By: Elizabeth A. Potter—Affinity Consulting Group

Contraction in all industries is normal. Contracting and expanding markets are cyclical. What is interesting is that some companies survive and some don't. So what is it that survivors do better? How can your firm survive by learning the lessons of successful companies?

Before examining the factors of success in contracting markets, it is important to note that return on investment to shareholders seems to have nothing to do with longevity. An article in Bloomberg BusinessWeek studies this topic and states, "The profitability of a company was a symptom of corporate health, but not a predictor or determinant of corporate health. Certainly, a manager in a long-lived company needed all the accounting figures that he or she could lay hands on. But those companies seemed to recognize that figures, even when accurate, describe the past. They do not indicate the underlying conditions that will lead to deteriorating health in the future. The financial reports at General Motors, Philips Electronics, and IBM during the mid-1970s gave no clue of the trouble that lay in store for those companies within a decade. Once the problems cropped up on the balance sheet, it was too late to prevent the trouble."

This study points out that there are definite contributing factors as to why some survive. Among the most important internal characteristics of surviving and thriving are a strong sense of identity and a relationship with the society around them, solid vision, frugality with expenditures, and tolerance for experimentation to test new ventures. How can your law firm internalize and use these attributes to survive and thrive in our contracting market?

Identity

Let's talk chocolate! A good example of a company with an undying identity is the Hershey Company. Started in 1894, Hershey was originally a manufacturer of caramel, and chocolate was only produced to be a sweet coating for the treat. In 1900 they started to produce chocolate bars and make them at a lower cost than former confectioners, boosting sales and giving them a firm, all-American identity within their culture and to the world. From their Pennsylvania location, close to ports and dairy farms, they were able to keep production costs low. They were a big success—chocolates, once only for the rich, became affordable to the average American. But then came wars and the Great Depression, and new products were offered to keep business going amidst a terrible downturn. Labor unions and new laws created difficulties that Hershey had to adapt to or they would fail. But they kept moving forward, never losing their vision. They were creative—in WWII the company's machine shop was used to create parts for the Navy's antiaircraft guns, and RATION D bars were created for the troops (yum!). Would we expect any less from this American company? Recently I spoke with a VP of sales who had been with Hershey for 30 years. He said he would never leave, and had never wanted to leave, although he had been offered more prestigious positions with the inevitable higher salary (he manages 700 salespeople nationally). He is passionate about the company and its products, and most importantly he knows how they will treat him. Because they have clearly set forth their identity to their employees and to their consumers, he never has to look over his shoulder. The qualities of Hershey that make it different from other companies in their industry for their consumers, the public, and their employees are consistently portrayed in how the company operates, its marketing, and its relationship with employees. There is no disputing that Hershey has a strong sense of identity, and their relationship with the society around them is unmistakable. As a law firm, you too must establish your identity in the industry.

Vision and Values

Again, at Hershey they state a simple vision, "We bring goodness to the world through great-tasting snacks. One smile, one moment, and one person at a time." They commit to serving the communities they live and work in through various charities. Milton Hershey School serves underprivileged children, and a school in Ghana does the same. The organization communicates its vision before all else, and its structure, values, and daily work product are built on this vision (see www.thehersheycompany.com/social-responsibility.aspx). A corporation's vision and values let all who work there know what to expect. The employees know how the company will react to their industry because they know what its values are. They know how they will be treated inside the organization and are expected to perform to its standards. Companies that run into trouble on this front are those that state a vision and values, but whose upper management is not true to them or whose employees lack knowledge, tools, and resources to live and work according to them. Values such as professionalism can be hard to understand from top to bottom in an organization. But clarifying and pointing out specific examples of what constitutes professionalism is vital so that employees can understand what behaviors should be modeled and what behaviors are unacceptable. Company management must have the courage to live the values every day. That is where the rubber meets the road and even sacred cows may die.

Expenditures

After discussing an interesting company like Hershey, I regret that I must take it down to the mundane level of basic accounting, but that is where much of the problem lies. The idea of lowering expenses is easy. The reality is somewhat cloudy and often confusing. If I have certain revenue that is dependable, and my expenses are in line with that level of revenue, my company is safe. The problem is that we are in an industry of high cost of production, low unit revenue, and volume downswings. This calls for the resource called retained earnings. Companies in industries such as ours triple their costs when they lean on a line of credit to front costs and then end up with debt, interest payments on the debt, and resulting issues. Retaining earnings in the company helps combat the highs and lows without acquiring debt. Additionally, expenditures on efficient technology that decreases the need for manual touch help to keep payroll cost at a minimum while allowing for volume increases and decreases.

Testing New Ventures

So back to Hershey. How do they keep the brand rolling and continue to push sales in the world of chocolate? Try new ventures! How about a huge M&Ms store on Times Square? Now Hershey owns the distributor. Technology pushed them to be more web-based and to offer technologically advanced products—M&Ms in your school colors anyone? Take note that they never strayed from the product—it's still all about the chocolate. How do you diversify and keep your core business strong? First identify what you do well and what you don't, not what you think or want to do well, but what your clients and the numbers tell you. Then build on your strengths, understanding your potential market share. How is the product distributed, should you be the distributor? Is it through technology or something else? Constantly question and challenge your company to grow and change, but never lose sight of your chocolate. Therein lies your longevity.

National

What's In A Complaint?

By: Jennifer Monty Rieker—Weltman, Weinberg & Reis Co., LPA

Comments, questions, or concerns? Just a few years ago, the comment box in a local bank may have had a few cards dropped in about interest rates or how to provide customer service. But now, with the assistance of the Consumer Financial Protection Bureau (CFPB), consumers have easy access to submit their complaints and concerns to the industry's watchdog.

On the first day that the CFPB opened its door, it simultaneously accepted consumer complaints. Initially, the CFPB accepted complaints related to consumer credit cards but has since expanded to address complaints for all consumer financial products, including mortgages and mortgage servicing.

The complaint process is simple for consumers to use and understand. A consumer can lodge a complaint by email, fax, phone, or by using the online "Submit a Complaint" feature on the CFPB website. The consumer merely needs to pick the product it is complaining about and then describe the problem it had and answer a few other questions.

Once the complaint is received by the CFPB, the CFPB screens it to ensure that it falls within its areas of enforcement, determines if it is submitted by a consumer (or its authorized representative), and verifies that it is not a duplicate complaint. After the complaint is screened, it is sent to the company using a secure web portal to verify that the company has a relationship with that consumer. Then, the company has 15 calendar days to respond to the complaint or to respond that it is a "work in progress" and will provide a final response in 60 days.

The ease of filing complaints has given consumers a voice to express their concerns with products and the service they received. Based on the release of statistics, the public is actively submitting complaints.

A Snapshot of Complaints

On July 16, the CFPB issued "Consumer Response: A Snapshot of Complaints Received," which reviews complaints received from July 21, 2011, through June 30, 2014. The Snapshot reports provide statistics about not only the number of complaints filed, but also the type of complaints filed.

In total, the Snapshot reports that the CFPB has registered approximately 395,300 consumer complaints since July 21, 2011. The number of people filing complaints has increased, with the volume of complaints rising 80 percent from 2012 to 2013. The breakdown by product shows that of all complaints received, 134,300 complaints (or 34 percent) were mortgage related.

For each product, the CFPB provided further details. When broken down by type of mortgage product that consumers complained about, 28 percent of consumers filed complaints relating to conventional fixed-rate mortgage, while 10 percent of consumers filed complaints about conventional adjustable-rated mortgages (ARMs). Forty-five percent of mortgage complaints were placed in an "other" category, while 8 percent of complaints centered around FHA loans, 4 percent involved home equity loans or lines of credit, 2 percent on VA loans, 1 percent on reverse mortgages, and 1 percent on second mortgages. Regardless of the type of mortgage, the Snapshot further breaks down the types of mortgage complaints received, reporting that 56 percent of all complaints related to problems when the consumer was unable to pay, 28 percent involved making payments, and 9 percent involved a consumer applying for the loan.

The Snapshot indicates that complaints regarding a consumer's inability to pay focused on issues relating to loan modifications, collections, and foreclosures. In particular, the Snapshot identified that complaints included not amending a derogatory credit reporting following trial period plans, short sale issues, and fees charged to reinstate loans.

Amid all the numbers and statistics, it is clear that more consumers are taking the time to file complaints. And more consumers are filing complaints related to their mortgages than any other consumer product. Debt collection (which arguably may also include some complaints related to mortgage servicing) is second to mortgage, but it only accounts for 20 percent of all complaints. Similarly, credit reporting, which also may encompass mortgage accounts, generated 12 percent of all complaints filed. Despite the industry's best efforts at establishing clear lines of communication, streamlined loss mitigation programs, and easy-to-understand loan documents, consumers continue to raise issues.

Using the Complaint Database

Understanding the focus of consumers' complaints is vitally important for any company. It gives a company insight into what practices or procedures are impacting consumers. If a company continually has issues related to reporting loans as delinquent during loss mitigation, then the company may want to focus on a better way to communicate what will happen during the loss mitigation process. Conversely, if a company is not receiving complaints about loan modifications, it can serve as validation that its practices are understood by consumers.

As the Complaint Portal currently operates, anyone can sort the complaints by either company or type of complaint. The Portal also shows whether or how a company has responded. While the Portal provides valuable information to assess where the industry may need to address concerns, it can also provide a bevy of information for plaintiff lawyers or consumers. A quick search for complaints regarding loan modifications shows the number of companies, or the number of times in one company, where consumers have raised an issue regarding loan modifications. If complaints continue to go unanswered or consumers inform the CFPB that they are unsatisfied with the resolution, it may bring further scrutiny to an industry or company.

The CFPB has identified that companies should have a compliance management system, which would include addressing consumer complaints. Each company should have an internal complaint policy and complaint log. Using the CFPB complaint portal, the company can verify that complaints that are on the CFPB website are also being reported internally.

Proposed Changes to the Portal

Despite its current ease of use, the CFPB released a proposed policy for comment in July that looks to change the Complaint Portal. The proposal would allow consumers to write narrative complaints. Concerns were immediately raised about situations in which an upset consumer can write a narrative and have it published on the Complaint Portal without any oversight or fact checking. Essentially, a consumer could impact the reputation of a company with its narrative complaints, particularly if the consumer's account of the situation is factually inaccurate. Comments related to the proposed policy are due on September 22.

Regardless of its form, the ability to file complaints with the CFPB will be around for many years. How a company responds to the complaints filed against it and whether a company looks at addressing the trends shown in the complaints will have a major effect on that company.

National

Conflict Analysis and Resolution for Implementation of the CFPB's Mortgage Servicing Rules

By: Courtney Krause—Fabrizio & Brook, P.C.

The Consumer Financial Protection Bureau (CFPB) is a creation of Title X of the Dodd Frank Wall Street Reform and Consumer Protection Act. The agency is uniquely charged with regulatory authority over virtually every aspect of consumer credit transactions in the United States. This federal agency is an anomaly, with far-reaching power and the ability to operate with little public oversight, headed by a single director, not a bipartisan commission. In December 2011, federal regulations governing consumer protection were transferred to the CFPB, allowing consolidation of consumer protection powers. Among those transferred included the Fair Debt Collection Practices Act (FDCPA), Real Estate Settlement Procedures Act (RESPA), and the Truth In Lending Act (TILA). Congress authorized the CFPB's rule-making authority in 12 U.SC. § 5514, allowing "the bureau to exercise its authorities under federal consumer financial law to administer, enforce, and otherwise implement provisions of federal consumer financial law." The expansive reach of the CFPB's authority includes residential loan servicers and "covered persons," defined as any person, or that person's affiliate, like a service provider, "that engages in offering or providing a consumer financial product or service." 12 U.S.C. § 5481(6). While the CFPB has broad authority over federal consumer financial law, allowing it to reconcile conflicts within its regulations and the FDCPA, the same cannot be said in the bankruptcy context. New regulations implemented by the CFPB, which became effective January 10, have caused concern that attempts at implementation will result in violation of other existing laws.

Beginning in 2012 when the CFPB first proposed the new rules, experts recognized an immediate conflict with existing state and federal law, specifically with the FDCPA and the bankruptcy code. Servicers and attorneys alike questioned whether compliance with the new rules could be achieved when there was an automatic stay1 in place or in circumstances where a borrower had requested a cease and desist.2

Periodic Statements for Residential Mortgage Loans

The Dodd Frank Act established section 128(f) of TILA, subsequently codified as 12 C.F.R. § 1026.41. As we are aware, this regulation imposed strict requirements on mortgage servicers to send a statement for each billing cycle. Requiring a servicer to send a statement listing an amount due, on its face, places a servicer in a position where the action could be construed as a violation of the automatic stay or discharge injunction. Moreover, the regulation does not allow any modification in the statement requirement to differentiate between pre- and post-petition amounts owing in the context of a bankruptcy. In response, the CFPB carved out a specific exemption in 12 CFR 1026.41(e)(5), allowing servicers to withhold monthly statements once a bankruptcy petition has been filed. Comment 41(e)(5)-2 further provides that if a portion of the mortgage debt is not discharged, the servicer must comply with the monthly statement requirement beginning with the next due date following (1) dismissal of the case, (2) closure of the case, or (3) the borrower is discharged, whichever date is earlier. The CFPB has not taken a position on whether the monthly periodic statement would otherwise violate bankruptcy code, although even with such an opinion, it would not have any bearing on a court's findings to the contrary. As a result, servicers should strictly adhere to the exemption during a pending bankruptcy.

> *"Servicers should also be mindful of the inherent conflicts that exist with this regulation and corresponding exemption, as they will still be required to consider a borrower who has discharged a mortgage obligation in bankruptcy for any available government-sponsored loan modification programs."*

The CFPB has not imposed a similar exemption to the periodic statement requirement when a borrower has requested that the servicer cease communication under the FDCPA. As opposed to an exemption, the CFPB has declared that servicers cannot be liable under the FDCPA in the context of efforts to comply with this requirement. Presumably under its overriding authority over consumer financial law, the CFPB issued Bulletin 2013-12 on October 15, 2013, concluding that a borrower's cease and desist request does not exempt a servicer from compliance with certain communications required by Dodd-Frank nor does compliance create liability under the FDCPA.

While servicers adhering to the periodic statement requirement may find some security in the bulletin, the judiciary's acceptance of this position as an affirmative defense remains to be seen. Servicers and industry experts should continue to encourage the adoption of a blanket exemption to the periodic statement requirement in the context of a cease communication request, if only for the purpose of deterring litigation.

Early Intervention and Continuity of Contact

The new early intervention requirements codified in the RESPA require a servicer to make a good faith effort to establish "live contact" with the borrower by the 36th day of delinquency. By the 45th day of delinquency, the servicer must provide written notice to the borrower of available loss mitigation options. If the borrower responds, the servicer is obligated to maintain "continuity of contact" by implementing procedures to assist borrowers with available loss mitigation options.

The CFPB carved out more specific bankruptcy and FDCPA exemptions for these rules requiring direct contact with the borrower, making a servicer exempt from any obligation to establish live contact and early intervention, if the borrower is in bankruptcy or sends a cease communication request. The bankruptcy exemption also applies to any portion of the mortgage debt that the borrower discharges in bankruptcy. (Official Bureau Interpretation, Supplement 1 to Part 1024, ¶ 39(d)(1)-(2(ii)). Once again, the CFPB has not taken a position on whether continuation of early intervention and continuity of contact efforts would constitute a violation of the automatic stay. Servicers should seek appropriate relief from a bankruptcy court prior to taking any action to pursue loss mitigation during a borrower's pending bankruptcy.

Servicers should also be mindful of the inherent conflicts that exist with this regulation and corresponding exemption, as they will still be required to consider a borrower who has discharged a mortgage obligation in bankruptcy for any available government-sponsored loan modification programs. Moreover, the broad exemption from the early intervention and live contact requirements in 12 CFR §1024.39(d)(1) does not apply to the continuity of contact requirement in 12 CFR § 1024.40. This will likely arise in situations where a borrower seeks loss mitigation assistance from the servicer and, during the review process, files for bankruptcy. To achieve compliance, the CFPB's official bureau interpretation allows the servicer to assign personnel with specialized knowledge of bankruptcy law to assist the borrower. The servicer has the option of using a single point of contact, single purpose personnel, the servicer's internal bankruptcy unit, or outside bankruptcy counsel.

The above discussion does not amount to an exhaustive list of the CFPB's attempts at resolving regulatory conflicts, and the regulations will continue to evolve as the CFPB studies the issues and receives feedback from both sides of the industry. A breakdown of available exemptions as they pertain to mortgage servicing is provided below. These rules have fundamentally changed the mortgage servicing industry, and as a matter of practice, servicers should make every effort to implement allowable exemptions to minimize litigation exposure.

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States: *Arizona*

Does a Beneficiary of a Title Holding Trust Have Rights to Possess Property After the Death of the Borrowers of a Reverse Mortgage?

By: Kevin Hahn and Dale Martin—Malcolm ♦ Cisneros, a Law Corporation

Malcolm ♦ Cisneros, a Law Corporation, favorably resolved an issue recently for client OneWest Bank, FSB. Cited as Herman Randolph Meyer v. MTC Financial Inc., et. al., Case No. C2013-5467, the Superior Court of Arizona, Judge Christopher Staring addressed the issue of whether the son of deceased reverse mortgage borrower parents had the right to remain in possession of the family home after the death of his parents. After obtaining a reverse mortgage, the borrowers placed title to their home into a trust (the "Family Trust"). The son argued unsuccessfully that because he was an occupant in the property and a beneficiary of the Family Trust, Arizona Code Section 6-1705(D) permitted him to continue residing in the property until his death.

The court's reasoning turned on the legal interpretation of Subsection (D), which provides that: "A reverse mortgage does not become due and payable if the legal title to the property is held in the name of the trust and the occupant (emphasis added) of the property uses the property as a principal residence and is a beneficiary of that trust." It was the son's contention that he was both a beneficiary and occupant and, as such, based on the plain language of the statute he was entitled to stay in the home for the duration of his life even though he was not a borrower under the reverse mortgage.

> *"The court recognized that reading the statute as the son suggested essentially would have the effect of voiding Arizona's requirement that borrowers of a reverse mortgage occupy the property as their principal residence"*

The court agreed with OneWest Bank's position that the son's interpretation of Subsection D was contrary to the legislative intent and overall statutory scheme concerning reverse mortgages in Arizona. The court recognized that the parents' conveyance of title to the Family Trust would make the reverse mortgage "due and payable" pursuant to § 6-1705(C)(2). The court concluded that § 6-1705(D) exists to preclude such an event from making the loan "due and payable." Subsection D permits borrowers, the parents in this case, to place title in a trust. The court reasoned that the legislature's use of "the occupant," as opposed to "any occupant," supports the conclusion that the legislature intended to protect the "borrower" from "due and payable" consequences so long as he or she uses the property as a principal residence.

Indeed, the son's view would have the absurd result of permitting trust beneficiaries to establish trust after trust in succession or change the beneficiaries continually and never have the loan become due and payable despite language in the reverse mortgage loan documents to the contrary. The court recognized that reading the statute as the son suggested essentially would have the effect of voiding Arizona's requirement that borrowers of a reverse mortgage occupy the property as their principal residence. That would have caused havoc for reverse mortgage lenders.

States: *California*

California Appeals Court Reinforces Rule That Borrowers Lack Standing to Challenge Securitization

By: Robert W. Norman and Patrick S. Ludeman—Houser & Allison, APC

Over the last few years, borrowers have sued their loan servicers and the mortgage-backed security trusts that own the loans, alleging flaws in the securitization process. For the most part, California courts have ruled that a borrower lacks standing to challenge the securitization process. However, on July 31, 2013, the fifth appellate district in California in Glaski v. Bank of America ruled that a borrower could have standing to challenge a foreclosure based on securitization issues.1 This ruling was criticized and regularly challenged, but no appellate court had published an opinion directly disagreeing with Glaski until now. In Yvanova v. New Century Mortgage Corporation2, briefed and argued by Houser & Allison, APC, the appellate court held that borrowers do not have standing to challenge securitization. This decision is a win for the mortgage banking industry.

For decades, mortgage loans have been securitized. This has created numerous mortgage-backed securities, which sometimes involves multiple transfers of a loan before ultimately being included in an investment trust. Securitization is an acceptable process because a promissory note is a negotiable instrument that can be transferred from one creditor to another without changing a borrower's obligations under the loan.3 Borrowers who have fallen into default have attempted to challenge foreclosure proceedings by alleging that an improper transfer to a securitized trust results in an illegal foreclosure. This is used to delay foreclosures.

Before the Yvanova and Glaski rulings, the court in Jenkins v. JPMorgan Chase4 held that a borrower was an unrelated third party to securitization, and in that capacity, the borrower lacks standing to challenge any act related to the investment trust's transactions. The court reasoned that any perceived impropriety in the transfer of a promissory note would affect only the parties to the transaction and not the borrower.5 Borrowers would not be the victim even in the case of an invalid transfer, because a borrower's obligations under a promissory note remain unchanged regardless of who owns the beneficial interest. The Jenkins court also ruled that a borrower cannot challenge a sale based on an allegation that an assignment of their deed of trust did not comply with the securitized trust's pooling and servicing agreement.

In Yvanova v. New Century Mortgage, the borrower made Glaski-type allegations to challenge the securitization process and contend that the foreclosure was void. Ms. Yvanova's loan belonged to a mortgage-backed securitized trust (the "Trust") and had been securitized in 2007, which was before she defaulted on the loan. The Yvanova court agreed with the Trust's arguments that the borrower could not challenge a foreclosure based on alleged flaws in the securitization process because the borrower lacked standing. Therefore, any wrongful foreclosure cause of action premised upon those claims fails as a matter of law. Yvanova is the first California published appellate court decision to hold a borrower does not have standing to challenge securitization. The Yvanova court thus agreed with the court's reasoning in the Jenkins and disagreed with the Glaski decision.

Should you have any questions regarding the Yvanova ruling or any mortgage banking related issue, please contact Houser & Allison, APC. The firm was both trial and appellate counsel for the Trust in the Yvanova decision.

States: *Florida*

Prior Servicers' Records and the Business Records Hearsay Exception

By: Jennifer Lima-Smith and Collie Nolan—Gilbert Garcia Group, P.A.

Just as investors buy and sell mortgages, servicers change during the life of the loan. When transfers occur, the business records associated with the loan become valuable.

In Florida, hearsay is defined as "a statement, other than one made by the declarant while testifying at trial or hearing, offered in evidence to prove the truth of the matter asserted." § 90.801(1)(c), Fla. Stat. (2013). Hearsay is generally inadmissible unless an exception is provided. §§ 90.802, 90.803, Fla. Stat. (2013). Business records can fall within the hearsay exception of §§90.803(6)(a) and 90.804 Fla. Stat. (2013). They may be admitted if:

(1) the record was made at or near the time of the event;

(2) the record was made by or from information transmitted by a person with knowledge;

(3) the record was kept in the ordinary course of a regularly conducted business activity; and

(4) it was a regular practice of that business to make such a record.

Although "it is not necessary to call the individual who prepared the document, the witness through whom a document is being offered must show each of the requirements for establishing a proper foundation." Mazine v. M&I Bank, 67 So.3d 1129, 1132 (Fla. 1st DCA 2011); Yisrael v. State, 993 So.2d 952, 956 (Fla. 2008). The witness must establish personal knowledge of the matter recorded or the records information is supplied by someone with knowledge. See WAMCO XXVIII, Ltd., v. Integrated Electronic Environments, Inc., Case No. 2D04-2717 (Fla. 2d DCA 2005). A recent trend in Florida courts is the inability of current loan servicers being permitted to testify about prior servicers' records.

In Hunter v. Aurora, the First District appellate court examined the introduction of specific business records. Hunter v. Aurora Loan Services LLC, Case No. 1D12-6071 (Fla. 1st DCA 2014). The court found the testimony "failed to establish the necessary foundation for admitting the Account Balance Report and the consolidated notes log into evidence ..." Id.

Some courts interpret Hunter to apply to prior servicer acceleration letters. Witnesses should explain the onboarding process for the subject loan. Testimony should reflect the elements outlined in the hearsay rule exception. See Yang v. Sebastian Lakes Condo. Ass'n, Inc., Case No. 4D12-3363, 64 (Fla. 4th DCA 2013); Glarum v. Lasalle Bank National Association, 83 So.3d 780 (Fla. 4th DCA 2011); Weisenberg v. Deutsche Bank Nat'l Trust Co., 89 So.3d 1111, 1112 (Fla. 4th DCA 2012).

In conclusion, if prior servicers' records are used as evidence, best practice is to review the current servicer's onboarding process, review the business records exceptions to hearsay, and consult with counsel prior to signing affidavits, interrogatories, and prior to testifying at depositions and trials.

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Walz Group Promotes Compliance Expert

Walz Group promoted Maria Moskver, Esq., to chief compliance officer and general counsel. Moskver has been with the firm for nearly two years, serving as VP of compliance services. In her new CCO role, Moskover will helm the company's expanding compliance product offerings, which guide clients through the increasingly complex regulatory landscape.

Freedman Anselmo and Lindberg Welcomes New Attorney

Freedman Anselmo and Linderg LLC welcomed a new attorney to the practice—Crystal V. Cáceres. She will serve as associate bankruptcy counsel, working in the areas of bankruptcy, mortgage foreclosure, and creditors' rights. Cáceres is a graduate of Loyola University Chicago (2001) and Northern Illinois University College of Law (2008) and is licensed to practice law in the State of Illinois.

Affinity Taps New Business Development Consultant

Affinity Consulting Group hired Majenica Springer to join the firm as a business development and management consultant. Springer will work with Liz Potter and Liz Lamar on the management consulting and business development team, bringing her abilities and extensive relationships in default servicing to the firm's business development law firm clients.

Shapiro & Zielke Attorney Named 2014 Minnesota Rising Star

Shapiro & Zielke attorney Amanda M. Govze has been named to the 2014 Minnesota Rising Stars list. She was one of just 2.5 percent of lawyers in the state of Minnesota selected for inclusion on the list. Govze works in the firm's litigation department, where she advocates for the legal rights and interests of loan servicers and investors in state and federal court.

HUTCHENS LAW FIRM ATTORNEYS APPOINTED TO TOP POSTS

Partner and Supervisor of the firm's Default Servicing Litigation practice, Hilton (Hutch) Hutchens, was recently appointed to serve on the Board of Trustees of Fayetteville Technical Community College. Additionally, Hutchens was recently elected President of the Cumberland County/12th Judicial Bar Association.

Hutchens Law Firm associate attorney Sarah Miranda has been appointed to serve as President of Fayetteville Area Habitat for Humanity for a one-year term. She has served on the organization's board of directors since 2006.

Lanée Borsman, an associate attorney practicing in the areas of foreclosure and litigation, has been appointed to the Board of Directors of the North Carolina State Bar Lawyer Assistance Program (LAP), a service that provides confidential assistance to North Carolina lawyers to help them identify and address problems with alcoholism, other drug addictions, and mental health disorders. Lanée is an active volunteer for the program and also serves on the Board of Directors.

Fabrizio & Brook Hires COO

Fabrizio & Brook brought on John P. Marecki as its COO. Marecki joins the firm with more than 30 years of experience in the mortgage industry. Immediately ahead of his new post, Marecki served as SVP of default administration at Flagstar Bank, where he worked for 25 years.

Martin, Leigh, Laws & Fritzlen Adds New Partner, Associate Attorney

Martin, Leigh, Laws & Fritzlen has a new partner in Kevin McManus. He earned his Bachelor of Arts degree in government from the University of Notre Dame and is a 2006 magna cum laude graduate of St. Louis University School of Law. McManus is a member of the Kansas City Metropolitan Bar, Missouri Bar, Kansas Bar, and American Bar associations.

Additionally, the firm brought on Mark M. Haddad as associate attorney. Haddad will work with individuals and corporations in a wide variety of complex legal matters, focusing primarily on defending financial institutions and their officers in cases involving lender liability, employment disputes, and contract issues. He is a 2007 graduate of the University of Missouri – Columbia School of Law and a 2004 graduate of the Robert J. Trulaske College of Business at the University of Missouri.

Brock & Scott Recruits Senior Associate Attorney

Brock & Scott, PLLC, announced the hiring of senior associate attorney Glen Tschirgi to its Columbia, Maryland, office. Tschirgi has more than 23 years of experience handling bankruptcy, foreclosure, replevin, eviction, loss mitigation, and collection litigation matters on behalf of secured and unsecured creditors, national mortgage lenders, and default servicing companies. He is admitted to the Maryland Court of Appeals and the U.S. District Court and U.S. Bankruptcy Court for the District of Maryland. He received his Bachelor of Science, cum laude, in English from Towson University and his Juris Doctor from the University of Maryland School of Law.

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"Operation" continued from page 1

Regulation O and the Consumer Financial Protection Act, 12 U.S.C. § 5538.

The MARS Rule and Regulation O (collectively "Regulation O") prohibit any MARS provider from requesting or receiving payment until the consumer has executed a written loan modification agreement with their lender/servicer. 16 C.F.R. § 322.5(a), re-codified 12 C.F.R. § 1015.5(a). Regulation O explicitly prohibits MARS providers from misrepresenting any material aspect of any relief service (i.e., likelihood of success and/or amount of time necessary to complete a loan modification). 16 C.F.R. §§ 322.3(b)(1)-(2), re-codified 12 C.F.R. §§ 1015.3(b)(1)-(2). Further, Regulation O requires MARS providers to disclose that the company is not associated or approved by the government or any lender and that the lender may not agree to modify a loan. 16 C.F.R. §§ 322.4(a)(1)-(2), re-codified 12 C.F.R. §§ 1015.4(a)(1)-(2).

The general theme throughout the complaints is the failure to provide MARS disclosures and misrepresentations regarding the likelihood of securing loan modifications. The most frequent scheme entails MARS companies advocating on the borrower's behalf to secure a loan modification in exchange for a monthly payment. In the majority of cases, the companies never make an attempt to contact the borrower's bank. "We are taking on schemes that prey on consumers who are struggling to pay their mortgages or facing foreclosure," said CFPB director Richard Cordray. "These companies pocketed illegal fees—taking millions of hard-earned dollars from distressed consumers—and then left those consumers worse off than they began. These practices are not only illegal, they are reprehensible."

FTC v. Danielson Law Group (DLG). (14-cv-00896, District of Nevada, June 9, 2014). DLG promised homeowners that they would receive legal representation from "expert loan modification attorneys." DLG sent distressed homeowners mail solicitations that included specific information about the homeowner's mortgage and indicated they were pre-qualified for federal mortgage relief. One of the letters can be viewed in the recently unsealed complaint on the FTC's website. DLG used advertisements that falsely stated "only 5 percent of homeowners who go it alone are successful" and the attorneys at DLG "know the rules and regulations the banks [sic] don't want you to know about." DLG deceptively told consumers that it was affiliated with large lending institutions. DLG advised one consumer that his bank "specifically referred his account to [DLG] for assistance." DLG charged consumers $500–$3,900 upfront and $195 monthly. Many of DLG's clients never spoke with an attorney or obtained mortgage relief.

CFPB v. Hoffman Law Group (HLG). (14-cv-80931, Southern District of Florida, July 14, 2014). HLG convinced homeowners to pay for the opportunity to be involved in mass-joinder lawsuits against their bank. HLG collected more than $5 million from distressed homeowners by charging a $6,000 initial fee and on average $495 per month during the pendency of the alleged suits. HLG has filed a

handful of mass-joinder lawsuits. Many of the lawsuits have already been dismissed and none has resulted in the windfalls promised.

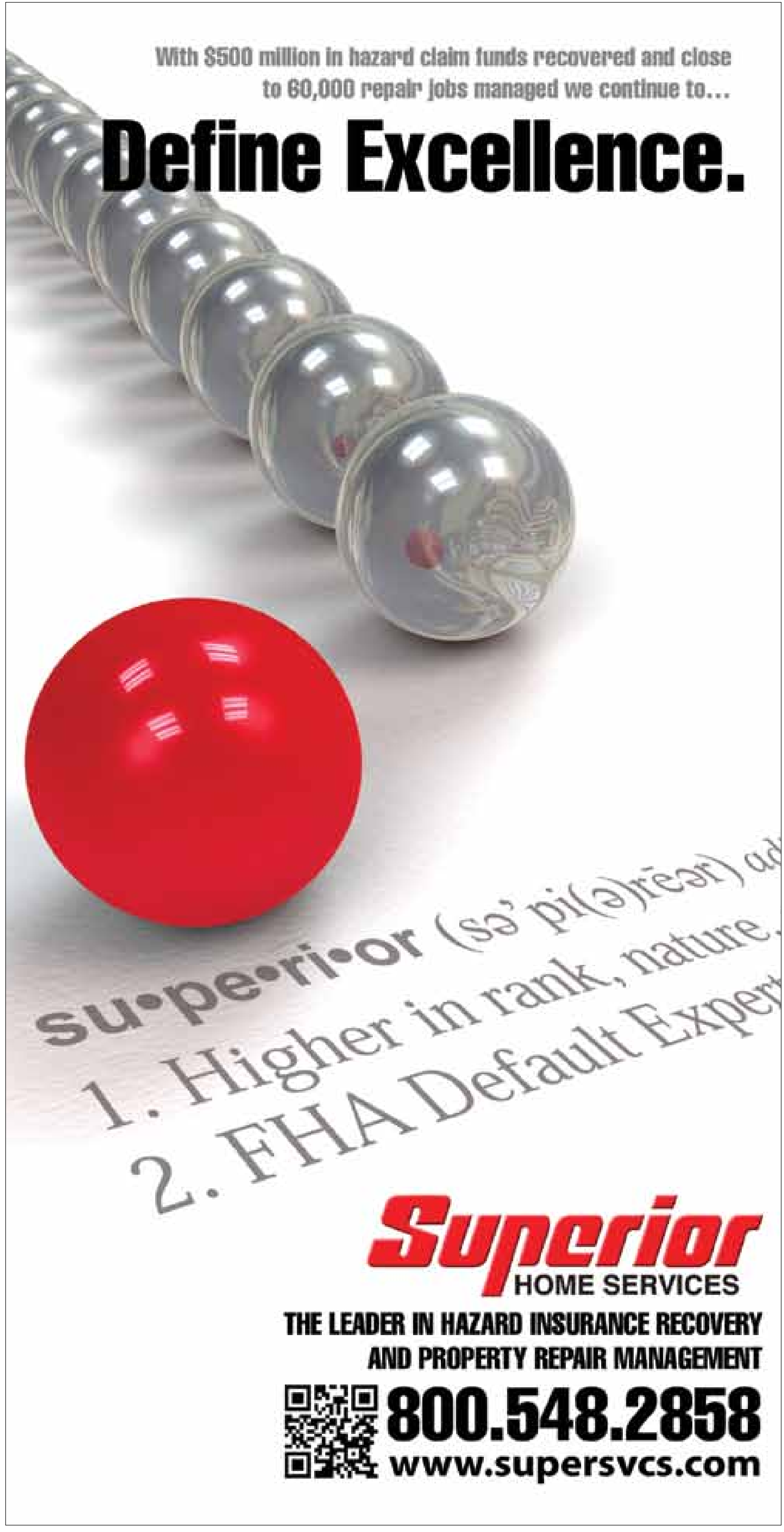
FTC v. Mortgage Relief Advocates LLC (MRA). (14-cv-05434, Central District of California, July 14, 2014). MRA advertised "predatory lending mortgage audits" on closing documents in which MRA found "legal violations on over 80 percent of the loans" they reviewed. MRA's website encouraged distressed homeowners to retain its services and "use these legal violations to knock out your lender with a swift upper cut." A majority of MRA's clients were charged up front $1,000–$3,200, plus a monthly fee, and received no assistance to help keep their homes.

FTC v. FMC Counseling Services, Inc. (FMC). (14-cv-61545, Southern District of Florida, July 7, 2014). FMC is accused of creating a false sense of legitimacy in their company by advising consumers that FMC employees were "federal loan officers" of non-existent governmental entities such as the "Federal Debt Commission." FMC created the "Federal Assistance Program" and advised consumers that if they were approved for the program, the Federal Debt Commission would purchase and service their mortgages at a significantly lower monthly payment. FMC advised homeowners to send their new monthly payment to the Federal Debt Commission and the money would be applied to their unpaid principal balance. FMC directed consumers to cease communication with their lenders and to disregard any warnings related to foreclosure proceedings.

Operation Mis-Modification and the Default Servicing Industry

The CFPB complaints estimate that $25 million was taken from homeowners. Attorneys are risking their licenses and engaging in unethical behavior to get a small fraction of that money. Operation Mis-Modification will take down a majority of the larger scam MARS companies; however, there will always be new MARS schemes that attempt to jump through regulation loopholes and fly under the government's radar. Many of these companies either tell homeowners that they have a relationship with banks or to not speak to their bank, as the foreclosure notices are "scare tactics." The default servicing industry should be vigilant and report scam MARS companies, as they are creating a general sense of distrust in the industry. In an effort to prevent future loan modification scams, the CFPB released a consumer advisory that included a model third-party authorization form for banks/servicers to utilize.

The CFPB is cracking down on all aspects of compliance with mortgage servicing regulations and is looking to make an example of companies that violate regulations. While the above cases seem like overt violations, there are other complaints based on minor infractions. We should educate our clients on Operation Mis-Modification so they are aware of the scams that affect our industry. Further, we can utilize this opportunity to emphasize the CFPB's desire to make an example of companies that violate regulations and the need for procedural safeguards to ensure strict compliance.



States: Illinois

Rescission May be Conditioned on Tender of Rescission Funds from Borrower

By: David Pustilnik—Potestivo & Associates, P.C.

On May 28, the Seventh Circuit issued an important decision regarding rescission claims under the Truth in Lending Act (TILA). In Iroanyah v. Bank of America, et al., 753 F.3d 686 (7th Cir. 2014), the plaintiffs filed suit seeking rescission of their loans as well as statutory damages under TILA. Specifically, the plaintiffs ("Borrowers") alleged that the loan documents provided by the lender "violated TILA (1) by failing to adequately disclose the frequency of payments because they did not specifically include the word 'monthly' in the payment schedule; and (2) by failing to supply the correct number of copies of the notice of right to cancel the loans." Id.

The United States District Court for the Northern District of Illinois "determined that modifying the rescission process by requiring the Iroanyahs to tender the amounts advanced to them before the banks released their security interests was a proper exercise of discretion under TILA." Id. Ultimately, borrowers were unable to tender rescission funds under the time frame established by the court. Id. Therefore, the district court entered judgment for the defendants on the rescission claims, and the borrowers subsequently appealed. Id.

The issue of rescission under TILA is something that the courts in Illinois have struggled with frequently. As recognized by the Iroanyah court, this is mainly due to the fact that "[t]he default procedures under TILA § 1635(b) and Regulation Z require the creditor to release its security interest and return all money paid in connection with the transaction before the borrower is required to tender full repayment." Id. However, this case finally gave the Seventh Circuit the opportunity to review the rescission process and define the discretionary powers of the courts to modify the default rescission procedures under TILA. The court proceeded with an analysis of whether the district court was within its discretion to require tender of funds before the security interests were released and interest payments returned, and whether in light of the failure to tender repayment, if dismissal of the rescission action was appropriate. Id.

The Seventh Circuit rejected the borrowers' argument that TILA bars any court from conditioning rescission upon repayment. The court stated that "[t]he Iroanyahs rely on a flawed interpretation of TILA and its implementing regulations and commentary" and that their arguments "evince a flawed conception of rescission." Id. The Iroanyahs contended that once a court determines rescission under TILA is available, it is fully unconditional whether or not principal is repaid. Id. However, the court held that "the Iroanyahs' arguments fail because they ignore the role of their own tender obligations in the process of rescission. Tender is inherently part of rescission, not an occasional effect of it." Id. (citations omitted).

The Seventh Circuit also reviewed the district court's rejection of the borrowers' proposed 26-year interest-free installment plan for abuse of discretion. Id. In affirming the rejection, it held that since the defendants were not the wrongdoers, and only assignees, a 26-year installment plan would have been inequitable. Id. The court also stated that the violations at issue were hypertechnical disclosure deficiencies, which the borrowers admitted caused no actual harm, and that the borrowers received the benefit of living in the property without making any payments during the pendency of the litigation. Id. Perhaps most importantly, it held that the proposed plan would effectively reform the original transaction to become an interest free loan and that this "would create a windfall for the Iroanyahs." Id.

The court stressed that a judge's discretion to amend rescission procedures is not limited to offering installment repayment plans to borrowers. Id. It further held that the borrowers are not necessarily entitled to a plan that will accommodate their circumstances, as TILA does not guarantee that borrowers can actually comply with the terms of rescission. Id. In fact, it explicitly recognized that "rescission is often unavailable to consumers because they are unable to return unpaid principal as a result of decreased property value, poor housing market, or any number of reasons." Id.

The Iroanyah decision effectively puts an end to the debate as to whether a district court is entitled to use its discretion to modify the procedures for rescission under TILA, including requiring the borrower to repay the loan proceeds prior to requiring the lender to release its security interest. If a borrower is unable to comply with the modified procedures for rescission, then the loan cannot be considered rescinded and the defendant will be entitled to judgment. The decision also finally defines when a loan is actually considered rescinded and when it is only "pending" rescission. Moving forward, lenders being confronted with rescission claims can look to the Iroanyah case as authority in support of a court using its discretion to modify rescission procedures and requiring a borrower to tender funds prior to the lender being required to release its interest.

States: Indiana

Vacant and Abandoned Properties Spur Tax Sale Reform in Indiana

By: Stephanie Reinhart-Rock and Andrew C. Clark—Manley Deas Kochalski, LLC

Indiana's legislature recently enacted Senate Bill 422, effective July 1, providing several new or modified tax and sheriff sale procedures designed to reduce the number of abandoned and vacant houses. The most comprehensive addition authorizes county executives, after judicial review and court order, to certify a list of vacant or abandoned properties to the county auditor for auctions starting July 1, 2015. While the county must follow the typical procedural and notice requirements for seeking a determination of abandonment, the remainder of the process to sell and complete transfer of the abandoned property is expedited by eliminating typical tax sale redemption periods occurring after the sale. The statutory additions provide that a county must notify any person with a substantial property interest of public record at least 120 days before the property is certified vacant or abandoned to the auditor for sale; however, once the property is certified for sale, a sale is conducted with only an additional 30-day published notice. The period of redemption following traditional tax sales has been specifically amended to exclude those properties sold pursuant to certification and sale as a vacant or abandoned property.

Importantly, while surplus proceeds from traditional tax sales require surplus funds to be available for distribution to parties divested of ownership, the new provisions for sale of vacant or abandoned property provide that "any amount remaining from the sale shall be certified by the counter treasurer to the county auditor for distribution to other taxing units during settlement." Ind. Code 6-1.1-24-1.5(c).

Finally, the bill addresses recent concerns that homeowners may not be aware of their ownership interests and legal responsibilities in properties that were slated for sheriff sale but later cancelled prior to any transfer of ownership. The newly added provision requires sheriffs to serve a written notice of the cancellation to each owner of the real estate at the cost of party who caused the sale to be cancelled.

In recent years, Indiana's tax sale process has seen several constitutional challenges, and we must question how these new provisions regarding abandoned property will stand up. With a statutory process that could divest an interested party of their property rights in as little as 173 days, while providing no post-sale right of redemption and eliminating a divested owner's right to sale surplus, this newest amendment is likely to experience its own scrutiny in the coming years. Regardless of potential constitutional challenges, the new statutory provisions are active on the books, and mortgagees need to develop processes to monitor and protect impacted property interests.

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States: Kentucky

MERS, Recording Statutes, and Assignments

By: Travis W. Thompson—The Law Offices of John D. Clunk Co., LPA

In what could potentially be the start of a nationwide trend (See, Montgomery County, P.A., vs. Merscorp, Inc., et al., 11-CV-6968, E.D. PA., 2014), published opinions in cases where homeowner and county recorder plaintiffs are attacking Mortgage Electronic Registration Systems, Inc., (MERS) and its member institutions for failing to record assignments are beginning to come to light. This particular scenario came to the forefront in Kentucky recently in Higgins v. BAC Home Loans Servicing, L.P., 2014 WL 1333069, (E.D.KY. 2014).

In Higgins, plaintiff homeowners claimed that defendant lenders "violated two Kentucky statutes because the defendants were assigned the mortgages securing the plaintiffs' notes but never recorded the assignments with the county clerk." See Higgins, 2014 WL 1333069 at 1. The two statutes involved KRS 382.360(3), which requires assignee of a mortgage assignment to record the assignment within 30 days of the assignment, and KRS 382.365(2), which requires that "an assignee of a lien on real property shall record the assignment in the county clerk's office as required by KRS 382.360."

> *"While the ruling Higgins is not a final, dispositive order, best practice in Kentucky dictates that any time a mortgage or underlying note is assigned, the assignment should be recorded within 30 days."*

While the court in Higgins ultimately interpreted Kentucky's statutory scheme to require all assignments be recorded, it appears that the legislative intent of these statutes, "to ensure that public records accurately reflect the current noteholder and lienholder on mortgaged property," weighed heavily on the court's decision. See Higgins at 6. In short, a failure to record all assignments was not only a violation of the black-letter statutes, but it also went against the intent of the legislature when drafting the statutes.

In determining whether a cause of action exists for homeowners, the court relied on KRS 382.365(3) and found that Kentucky's statutes do provide a private cause of action to homeowners when a lender fails to record a mortgage assignment. (See Christian Cty. Clerk v. Mortgage Elec. Registration Sys. Inc. 515 F. App'x 451 [6th Cir. 2013], where the Sixth Circuit held that Kentucky's county clerks "did not have a private right of action to sue for violations of recording statutes.") Homeowners' remedies are found in KRS 382.365(5) and "shall not exceed three times the actual damages, plus attorney's fees and court costs, but in no event less than $500."

While the ruling Higgins is not a final, dispositive order, best practice in Kentucky dictates that any time a mortgage or underlying note is assigned, the assignment should be recorded within 30 days. It will provide notice to the general public as to who the current noteholder and lienholder is, and more importantly lenders would be in compliance with Kentucky's recording statutes, avoiding the possibility of having to pay damages. The bottom line: Don't delay in recording assignments. It could cost you.

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conclusions. In an attempt to efficiently address challenges to the formation and operation of the MERS system, the Judicial Panel on Multidistrict Litigation transferred numerous cases filed in Arizona, California, Nevada, Oregon, and South Carolina into a single action in the Arizona federal district court, while leaving issues unrelated to MERS in the applicable states' federal district courts. When the Arizona court entered an order dismissing the plaintiffs' claims for failure to state a cause of action, the case reached the Ninth Circuit Court of Appeals.

On June 12, the Ninth Circuit issued its decision in In Re Mortgage Electronic Registration Systems, Inc., No. 11-17615, addressing the borrowers' claims for wrongful foreclosure under Arizona, California, and Nevada law, based on the allegedly irreparable split of the Note and Deed of Trust due to the presence of MERS; violation of Ariz. Rev. Stat. § 33-420 (recording false documents); violation of Nev. Rev. Stat. § 107.080 (nonjudicial foreclosure); aiding and abetting wrongful foreclosure under Arizona, California, and Nevada law; and aiding and abetting predatory lending under Arizona, California, and Nevada law. Claims originally brought under Oregon and South Carolina law were not pursued by the plaintiffs on appeal.

The Ninth Circuit declined to address the "split the note" theory, holding instead that in order to pursue the tort of wrongful foreclosure, the borrowers had to allege "lack of default, tender to cure the default, or an excuse from tendering." Because none of the plaintiffs had alleged they were current on the loan or had tendered an amount sufficient to cure their defaults, the lower court appropriately dismissed the wrongful foreclosure claims. This holding also allowed the Ninth Circuit to summarily dispose of the plaintiffs' claims for aiding and abetting wrongful foreclosure, as there was no underlying tort. Addressing the issue of MERS' authority to assign a note and deed of trust under Nevada law, the Ninth Circuit followed the Nevada Supreme Court's holding in Edelstein v. Bank of New York Mellon, 286 P.3D 249 (Nev. 2012) that MERS was a valid beneficiary and was able to assign its interest to the note holder.

Previously in Cervantes v. Countrywide Home Loans, 656 F.3d 1034 (9th Cir. 2011), the Ninth Circuit had affirmed the dismissal of a putative class action lawsuit alleging that MERS was fraudulently identified on residential mortgages and deeds of trust, which prevented borrowers from learning the identities of the actual holders of their notes and mortgages. The Ninth Circuit found that a fraud claim failed where the plaintiffs failed to identify any false statements about MERS or show they relied on any statements to their detriment, noting that the fraud claim was belied by the terms of the deed of trust that described MERS' role.

These decisions are in accord with those reached by the 10th (In Re Trierweiler, 2014 U.S. App. LEXIS 12501 [July 2014]), 11th, (Smith v. Saxon Mortgage, 2011 U.S. Dist. LEXIS 153327; aff'd 446 F. App'x 239 [2011]), Fifth (Martins v. BAC Home Loans Servicing, L.P., 722 F.3d 249 [2013]), and Fourth (Horvath v. Bank of N.Y., 641 F.3d 617 [2011]) circuits, all holding that either the note and the security instrument are not split, or if they are split, the split is repaired by assigning the deed of trust out of MERS. Logically it follows that if the note and security instrument are not split or the split can be cured by an assignment from MERS, then MERS can be a beneficiary of the security instrument (as has been concluded by courts in Nevada, Idaho, Illinois, Utah, Connecticut, California, and Texas). While Oregon, Washington, Montana, and Maine have found that MERS cannot be a beneficiary under a deed of trust under their state laws, none of the states as of this past June have used that as basis to invalidate the security instrument.

But while claims against MERS by borrowers seeking to invalidate their mortgages have been largely unsuccessful, some claims related to recording requirements have survived. Recently in the U.S. District Court for the Eastern District of Pennsylvania, (No. 11-CV-6968), the Montgomery County recorder of deeds obtained a judgment requiring MERS to "create and record written documents memorializing the transfers of debt/promissory notes which are secured by real estate mortgages in the Commonwealth of Pennsylvania for all such debt transfers past, present and future." The court there found that the recorder had a right to bring the suit under a quiet title theory (unlike contrary conclusions reached by courts in Kentucky, Georgia, Nevada, and Tennessee) and that she had a pecuniary interest in the recording of assignments. The evidence showed that between 2000 and 2012, the number of recordings by MERS had steadily increased, with a corresponding decrease in recording fees collected by the county recorder, leading to a purported loss of more than $15 million in recording fees. The extent of any actual damages has yet to be decided by the court.

This Montgomery County case is unique in adopting the premise that the note and mortgage are never separated under Pennsylvania law, and hence any time a promissory note with a security instrument is transferred, an interest in the property has been conveyed and a writing and recording are required. This case will be closely followed by the industry as it winds its way through the inevitable appeal, and as the industry strives to comply with the implications of an order requiring the recording of all debt transfers, past, present, and future.

From these decisions, it appears that while one battle over MERS draws to a close, another one rises to take its place. A majority of courts have refused to invalidate security instruments that name MERS as beneficiary and closed the door on borrowers seeking a way out of repaying the underlying debt. But the debate over MERS is long from over, as arguments over whether loan transfers must be publicly recorded have been given more life, at least in Pennsylvania.

States: Michigan

Michigan Appeals Court Holds Voluntary Mergers Don't Transfer Mortgage Interest by Operation of Law

By: Paul Poles—Potestivo & Associates, P.C.

In the recently published case Federal Home Loan Mortgage Association v. Kelley, No. 315082, the Michigan Court of Appeals addressed the recordation requirements of MCL § 600.3204(3) with respect to a successor mortgagee obtaining a mortgage by virtue of a voluntary merger. In the June 24 opinion, the court ultimately held that in order to establish the requisite chain of title to conduct a foreclosure by advertisement, an assignment of mortgage must be recorded from the merging entity into the surviving entity prior to the date of sale.

In 2003, the defendants in Kelley obtained a loan in the amount of $240,000 to purchase real property located in East Lansing, Michigan. The loan was secured by a mortgage on the property. The mortgage was subsequently assigned from the originator to ABN-AMRO Mortgage Group, Inc. (ABN-AMRO) and the assignment was properly recorded in late 2003. In 2007, CitiMortgage, Inc. (CMI) and ABN-AMRO merged. CMI was the surviving entity. In 2011, the defendants defaulted on the mortgage and CMI conducted a foreclosure by advertisement pursuant to MCL §§ 600.3201, et seq. Federal Home Loan Mortgage Association (aka, Freddie Mac) purchased the property at a sheriff's sale and the defendants failed to redeem.

Following the expiration of the statutory redemption period, Freddie Mac initiated eviction proceedings. The Kelley defendants contested the eviction alleging, in part, that there was a violation of MCL § 600.3204(3) because the chain of title lacked an assignment of mortgage to CMI. However, the district court rejected the defendants' argument. In doing so, the district court sided with Freddie Mac, which argued that mortgages acquired as the result of a merger are, ipso facto, obtained by operation of law—thereby eliminating the need for a recorded assignment of mortgage. A sequence of appeals followed shortly thereafter.

Ultimately, the Michigan Court of Appeals held that the merger between ABN-AMRO and CMI did not result in CMI acquiring the mortgage by operation of law. In doing so, the court relied on the operation of law designation set forth by the Michigan Supreme Court in Kim v. JP Morgan Chase Bank, N.A., 493 Mich 98 (2012). Focusing on the fact CMI voluntary entered into a merger agreement with ABN-AMRO, the court held the mortgage was not passed to CMI "unintentionally, involuntarily, or through no affirmative act of the transferee." 1 In rejecting Freddie Mac's arguments to the con-

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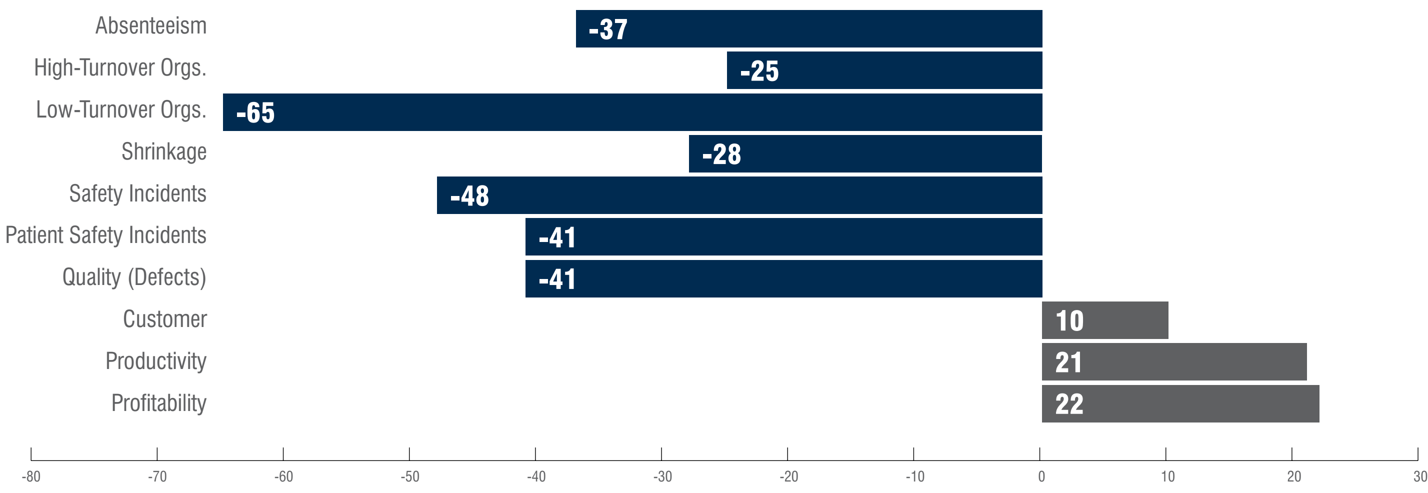

"Employee Engagement" continued from page 1

Gallup found in 2013 that employee-engagement programs have a powerful impact on the company's bottom line. Gallup researchers compared work units in the top and bottom 25 percent of its client database, finding "higher rates of productivity, profitability, and customer ratings among the most engaged work units, as well as less turnover and absenteeism, and fewer safety incidents."

According to the Gallup study, ensuring focus on employee engagement increases the ability for companies to engage employees to increase their effort to reach performance goals. Gallup's research links engagement to nine business objectives, one of which is profitability.

How Can I Increase Employee Engagement?

According to SHRM, key workplace conditions that navigate the levels of employee engagement are relationships, ability to communicate and to receive communication, opportunities for career development and advancement, positive reinforcement, quality of work, and opinion of the company.

RELATIONSHIPS

Relationship with co-workers – People like to come to work and hang out with people they like. Providing occasional opportunities for employees to interact on a social basis, such as brown-bag lunches or community service events, is a great way to foster this type of atmosphere.
Relationship with immediate supervisor – Most people do not "quit companies"; rather they "quit bosses." Not all managers are great communicators and not all managers are a good fit for management. It is critical that you use the proper selection when hiring managers and ensure they are prepared for the job. Below-par managers result in high turnover.

ABILITY TO COMMUNICATE AND RECEIVE COMMUNICATION

Communication between employees and senior management – It is critical that employees feel they have a voice and that they receive frequent information on "where the firm is going." With absence of information, employees come to their own conclusions, and those conclusions are often not accurate.

Opportunities for career development and advancement

Contribution of work to organization's business goals – Let employees know how their job impacts the bottom line.

Career development opportunities – In small firms, this may seem impossible, but simple things like cross training in other areas can fill this void.

POSITIVE REINFORCEMENT

Management recognition of employee job performance – Implementing simple low-cost programs that promote positive recognition between peers as well as between management and staff are an easy way to ensure your employees receive regular feedback. Encouraging and equipping your managers with the tools they need to carry out this very important task.

QUALITY OF WORK

Opportunities to use skills/abilities – Most people want to feel they have a purpose in the workplace and that their skills are valuable. Allowing them the opportunity to focus on their strengths and abilities results in a happier, more satisfied employee.

Autonomy and independence – Nobody likes to feel as if they are micro-managed, and if they are a high-performing, dedicated employee, they should not need the micro-managing. If they do, you may have the wrong employee.

OPINION OF THE COMPANY

Organization's financial stability – This may be a difficult topic to discuss with employees, as it is sometimes a very tightly held confidential matter between partners. Nevertheless, it is possible to share a confident message without disclosing the details of your financial statements.

Overall corporate culture – Good employees do not last long in a bad culture, and high turnover creates compounding cultural issues, training issues, and quality issues. If you are not sure what your culture is, it could be a sign that you have some work to do.

Organization's commitment to corporate social responsibility – There are some simple, low-cost ways to implement this into a firm's culture, and it is an item that ranks high on many people's list of needs from their employer.

How Can I Measure Engagement?

There are a variety of engagement survey tools that can be administered by your human resources staff or a human resources consultant. Surveys can give you more granular data, but some other simple ways to know whether you have an engaged workforce include reviewing exit interview data, analyzing turnover statistics, reviewing productivity numbers, conducting quality audits and reviewing those results, and conducting informal meetings with staff just to check in and see what they think and how they feel about their work and the firm overall.

Examples of what some "Engagement Behaviors and Opinions" look like are listed below. (Information courtesy of SHRM.)

- I am determined to accomplish my work goals and confident I can meet them.
- I frequently feel that I'm putting all my effort into my work.
- While at work, I'm almost always completely focused on my work projects.
- I feel completely plugged in at work, like I'm always on full power.
- I enjoy volunteering for activities beyond my job requirements.
- In my organization, employees are encouraged to take action when they see a problem or opportunity.
- My colleagues quickly adapt to challenging or crisis situations.
- Employees in my organization deal very well with unpredictable or changing work situations.
- My work group never gives up.
- Others in my organization view unexpected responsibilities as an opportunity to succeed at something new.

Do you think the above behaviors and opinions exist in your firm? If you are not sure, do some digging. The answers may surprise you.

"Michigan" continued from page 19
trary, the court reasoned that Kim's discussion of mergers focused on those initiated by the FDIC under 12 U.S.C. § 1821 as opposed to mergers in general. As a result of the foregoing analysis, the court held that in order to comply with MCL § 600.3204(3), a recorded assignment of mortgage from ABN-AMRO to CMI was required.

However, despite the lack of assignment from ABN-AMRO to CMI, the court further held that the underlying foreclosure was merely voidable, not void ab initio. Relying on Kim once again, the court determined that "because defendants did not allege that the defect amounted to prejudice, they were not entitled to any relief and the district court properly entered an order terminating defendants' possession of the property."

On July 15, Freddie Mac filed a Motion for Reconsideration, arguing, in part, that the court in Kelley ignored Michigan statutory2 and case law, which negate the need for an assignment of mortgage in merger situations. Kelley filed an answer on July 29. At the time of publication, there was no decision on the Motion for Reconsideration. Based on the same, the Kelley case and its controversial holding will likely remain on the industry radar for the foreseeable future.

If you have any questions about this case, please contact associate attorney Paul Poles at ppoles@potestivolaw.com or 248.853.4400, ext. 1170.

States: Minnesota

Minnesota Interprets State Statute to Allow Mortgagor to Pursue Damages for Loan Servicer's Breach of Servicer Participation Agreement

By: Amanda Govze—Shapiro & Zielke, LLP

This past April, the Minnesota Supreme Court interpreted Minn. Stat. § 58.18 sub. 1 (2012) and held that the statute provides a private right of action for a mortgagor to pursue damages for a mortgage servicer's breach of its agreement with its investor. Gretsch v. Vantium Capital, Inc., 846 N.W.2d. 424 (Minn. April 2, 2014).

> *"The court reasoned that even though plaintiff had no claim under common law, the statute expressly provided her with a private right of action."*

Minn. Stat. § 58.13 prohibits a person acting as a residential mortgage servicer from failing "to perform in conformance with its written agreements with borrowers, investors, other licensees, or exempt persons." Minn. Stat. § 58.18 subd. 1 provides that "a borrower injured by a violation of the standards, duties, prohibitions, or requirements of sections 58.13, 58.136, 58.137, 58.16, and 58.161 shall have a private right of action" and may be awarded damages, punitive damages, costs, and reasonable attorney fees.

In Gretsch, plaintiff filed suit contending that Minn. Stat. § 58.18 gave her standing to bring claims against her loan servicer, Vantium Capital, Inc., d/b/a Acqura Loan Services (Acqura) for an alleged breach of the Servicer Participation Agreement (SPA) between Acqura and Fannie Mae, a contract to which plaintiff was not a party. Gretsch, 846 N.W.2d 424. The SPA required a loan servicer who participates in HAMP to comply with certain actions prior to commencing with foreclosure proceedings. Plaintiff alleged that Acqura breached the SPA by failing to process her loan modification request pursuant to the directives of the SPA, resulting in the premature foreclosure of her home. Id. at 427–28.

The district court dismissed plaintiff's claims concluding that she did not have standing under Minn. Stat. § 58.18 because HAMP does not create a private right of action and because the SPA did not give rise to her third-party beneficiary claim. The Minnesota Court of Appeals affirmed finding that the statutory language was ambiguous and declined to extend enforcement of the SPA's contractual rights to plaintiff because she was not a party to the SPA or an intended beneficiary of the SPA. Id.

The Minnesota Supreme Court granted plaintiff's petition for review and reversed the lower courts, holding that the plain language of Minn. Stat. § 58.18 gave plaintiff standing to seek damages from Acqura's alleged breach of the SPA. Id. at 432. The court reasoned that even though plaintiff had no claim under common law, the statute expressly provided her with a private right of action. The court was not persuaded by Acqura's concern that if plaintiff was provided with a private right of action, it would lead to absurd results due to possible "unlimited and disruptive litigation by parties with no relationship to the myriad of agreements that servicers have with other entities." Id. at 430.

States: Ohio

Lien Avoidance and Survivorship Tenancy – A State Divided

By: D. Anthony Sottile—Freedman Anselmo Lindberg, LLC

Pursuant to 11 U.S.C. §522(f), if a judicial lien impairs a debtor's homestead exemption, then a judicial lien can be avoided and cancelled. The equation is a simple one: A lien impairs an exemption to the extent that the sum of all of the liens on the subject property, plus the exemptions the debtor would be entitled to if there were no liens, is greater than the value of the debtor's interest in the property as if there were no liens.

In Ohio, a property deed that grants an interest to multiple people, "for their joint lives, remainder to the survivor of them," creates what is called a survivorship tenancy in the grantees (Ohio Rev. Code §5302.17), and "each survivorship tenant holds an equal share of the title during their joint lives unless otherwise provided in the instrument creating the survivorship tenancy. Ohio Rev. Code §5302.20(B). When a grantees dies, the title in the property passes equally to the surviving tenants.

A recent case out of the Southern District of Ohio, In Re Kindall, 12-60841, decided earlier this year, ruled that in cases where only one party to the survivorship deed files bankruptcy and seeks to avoid a judicial lien, only half the value of subject property is used in the equation outlined in §522(f). Kindall held property with his wife as the only two parties in a survivorship tenancy. Kendall's spouse was not a party to his bankruptcy. Having to use the strict interpretation of §522(f) as required by the Sixth Circuit Court of Appeals in Brinley v. LLP Mortgage, Ltd. (In re Brinley), 403 F.3d 415 (6th Cir. 2005), the bankruptcy court in Kindall used the full balance of all of the liens on the property and weighed the total of the liens against the debtor's half interest in the property. This resulted in the judicial lien exceeding the amount of the impairment, and thus the lien was deemed fully avoidable against the debtor's interest in the property.

This is in direct conflict with recent rulings out of bankruptcy courts in the Northern District of Ohio, which have ruled that in cases where only one party to the survivorship deed files bankruptcy and seeks to avoid and cancel a lien under the same pertinent fact pattern as in Kindall, the debtor is only charged with half of the total debt balance. The court in Kindall noted Lavine, 2012 WL 4106749 (Bankr. N.D. Ohio, Sept. 18, 2012) and In re Law, 2013 WL 4078844 (Bank. N.D., Aug. 13, 2013) in making that same distinction.

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LEGAL LEAGUE 100 ~ *In Pictures*

1. Martin, Leigh, Laws & Fritzlen, P.C., attorneys Richard Martin, Steve Leigh, Carrie Mermis, and Dustin Stiles sponsored and participated in the Second Annual Henning Family Foundation Golf Tournament, held at Staley Farms Golf Club May 9. The event raised $140,000 toward placing 25 automated external defibrillator (AED) units at area sports complexes. **2.** Freedman Anselmo Lindberg (FAL) employees teamed with nonprofit organization Feed My Starving Children to hand-pack meals specially formulated for malnourished youngsters. FAL's efforts helped pack more than 90 boxes containing enough meals to feed 54 children for a year. **3.** Potestivo & Associates, P.C., raised $3,000 for the American Cancer Society's signature event, Relay 4 Life, held June 21–22 in Rochester Hills, Michigan. The firm's various departments organized a range of fundraising events, including bake sales, 50/50 raffles, and silent auctions. **4.** Several Rubin Lublin, LLC, employees and their family members participated in a local 5K run/walk on Saturday, May 17, benefiting the Emory Johns Creek Hospital. **5.** Butler & Hosch associates play a game of charity football at McKinnish Park in Carrollton, Texas.

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