Mortgage Servicing Enforcement and Litigation: The Second Wave

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MORTGAGE SERVICING ENFORCEMENT AND LITIGATION: THE SECOND WAVE

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At present, the mortgage servicing industry is under increased enforcement and regulatory scrutiny on the state and federal levels. Concurrent with this development, the industry is experiencing a proliferation of class action litigation nationwide. Although mortgage servicers have been subject to widespread governmental intervention and litigation for a number of years focused on the origination process, until recently there has been little focus on *servicing* practices.

In 2003, however, mortgage servicers witnessed a sea change in the nature of adverse proceedings they would face with the joint filing, in United States v. Fairbanks, of the first major action by federal agencies against a subprime lender based exclusively on alleged predatory *servicing* practices. That action followed a joint FTC and HUD investigation during which the agencies found that Fairbanks had violated the Real Estate Settlement Procedures Act (RESPA), the Federal Trade Commissions Act (FTCA), the Fair Credit Reporting Act (FCRA), and the Fair Debt Collection Practice Act (FDCPA). The accompanying consent decree required Fairbanks to pay $40 million and its CEO $400,000 to consumers, enjoined Fairbanks from future violations, and imposed new limitations on its servicing practices. At the time, HUD Secretary Mel Martinez reportedly commented that "Today's settlement makes clear that HUD and FTC are serious about protecting consumers from those who would try to steal their American dream[;] . . . those who seek to take advantage of unsuspecting homeowners will be

tracked down and held accountable."[1] The FTC-HUD settlement was negotiated in conjunction with and became final upon court approval of a related class action settlement.

While Fairbanks signaled the federal agencies' resolve to punish mortgage servicers that treat consumers unfairly or deceptively, perhaps even more ominous for mortgage servicers was the fact that some aspects of the settlement prohibited conduct that is undefined and otherwise unregulated, and neither FTC nor HUD have indicated any intent to promulgate regulations or issue policy statements to clearly articulate the scope of proscribed servicing conduct. Further, experts predicted that the settlement would become de facto best practices standards against which federal and state regulators increasingly would seek to measure servicing practices.

Mortgage servicers did not have to wait long to see these predictions realized. For example, in April 2004, Ocwen Loan Servicing entered into a Supervisory Agreement with the Office of Thrift Supervision ("OTS") that prohibited Ocwen from charging residential borrowers for forced-placed insurance without first permitting the borrowers an opportunity to demonstrate that coverage already exists, and enjoined Ocwen from placing borrowers in default, foreclosing, or assessing late fees solely due to nonpayment of hazard insurance premiums. The Supervisory Agreement also prohibited Ocwen from charging certain fees related to the foreclosure process and required that the company adopt a plan to improve its customer service, including its handling of consumer complaints and disputes. In particular, the Agreement requires that Ocwen implement a borrower "dispute resolution initiative" plan and adequately staff its Office

[1] Federal Trade Commission Press Release of November 12, 2003, *available at* www.ftc.gov/opa/2003/11/Fairbanks.htm.

of Consumer Ombudsman to handle borrowers' questions or complaints, and that Ocwen develop a "borrower-oriented customer service plan" setting forth goals of "high-quality service" practices that meet or exceed existing law.

In addition, Ocwen currently faces federal multi-district class action litigation in the Northern District of Illinois involving the consolidation of in excess of 60 lawsuits involving alleged unlawful loan servicing practices. Ocwen has also had an $11.5 million jury verdict in an individual case alleging that it had engaged in knowingly deceptive practices in servicing a home equity loan. Numerous additional single borrower cases are already pending against Ocwen.

Other mortgage servicers likewise have not escaped the attention of class action lawyers. Numerous class action cases are pending against virtually every major loan servicing company. These cases often closely track the Fairbanks and Ocwen actions, alleging multiple violations of state and federal law, including alleged violations of RESPA, the FTCA, the FCRA, the FDCPA, and state contract and consumer protection laws. More specifically, Plaintiffs' claims include assertions that the mortgage servicers:

- failed to accurately or timely post payments;
- incorrectly denominated an unapplied payment as being held in suspense status;
- imposed and collected late fees when loan payments were made on a timely basis;
- improperly assessed and collected certain fees, including attorney's fees and costs, excessive late charges, inspection fees, payoff fees, recording fees, escrow fees, NSF fees on "good funds," and fees for costs not actually incurred;
- adjusted interest rates without proper notice and applied the monthly payments to improper escrow advances;

- obtained forced-placed insurance coverage when borrowers had coverage in place;
- improperly initiated foreclosure proceedings;
- wrongfully rejected mortgage payments made under the terms of forbearance agreements; and
- demanded costs incurred in connection with improper foreclosure proceedings.

Given these developments, it is imperative that mortgage servicers take steps, in the form of a continuing, comprehensive risk analysis of their servicing practices, to identify and appropriately respond to early warning signs of areas within the company in need of improvement. This self-analysis should be undertaken with the goal of ensuring that the company's servicing policies, procedures, and practices are at or above industry "best-practices" standards in order to minimize the likelihood that they become the target of private litigants and governmental enforcement and regulatory scrutiny. Although the Fairbanks and Ocwen settlements provide some guidance concerning the "best practices" to which federal regulators expect companies to adhere, it appears that this standard will continue to evolve case-by-case as pending and future servicing actions are resolved. Nonetheless, as discussed in further detail below, examining and understanding the interrelationship between customer complaints, government enforcement and regulatory oversight, and class action litigation will assist mortgage servicers in discerning certain best practice policies they should implement in order to avoid or minimize their exposure to such adverse actions.

Beyond Fairbanks *and* Ocwen*: Towards an Industry Best Practices Standard*

It is evident, following Fairbanks and Ocwen, that certain key areas of mortgage servicing practices are subject to heightened regulatory oversight and litigation risk, including: (1) the handling of consumer payments; (2) the assessment and collection of fees; (3) forced place insurance; (4) credit reporting; and (5) foreclosure procedures. This focus is also indicated by the numerous consumer complaints servicers and governmental agencies review with respect to these issues from consumers. Indeed, in both Fairbanks and Ocwen it was the accumulation of complaints by dissatisfied consumers that brought the attention of the media and, ultimately, government enforcement agencies.

In many cases, mortgage servicers can mitigate their exposure to reputational risk and serious financial consequences by diligently maintaining and reviewing their legal department's files as part of a more comprehensive risk assessment analysis. The effectiveness of this approach however, requires that the company routinely track borrower litigation --- including single borrower actions and governmental inquiries ---as well as all consumer complaints. Indeed, one of the most effective means of risk management available to mortgage servicers is an adequate consumer complaint tracking and resolution process to address such complaints promptly and professionally. Such a process should entail, at a minimum:

- A consumer "Complaint Response Unit" to ensure consistent, coordinated and documented handling of all consumer complaints; the unit should be trained in the company's policies concerning the handling of complaints and should be responsible for the receiving, processing, tracking, and the initial response to complaints;

- The maintenance of a centralized, consumer complaint call center manned by members of the company's Complaint Response Unit;
- A commitment to address problems that are brought to the company's attention;
- The maintenance of a database to track complaints;
- Routine risk assessment to identify complaints that indicate possible systemic problems within the Company or that are otherwise non-routine;
- In-house counsel oversight of non-routine complaints;
- Follow-up on status of complaints to ensure that they are not left unresolved.

Consumer complaints should also be reviewed for substance and volume, as a high number of legitimate complaints indicates an increased likelihood that the company will end up in litigation. Critical, too, to the complaint resolution process is that the servicer implement a policy and procedure for the follow-up on the status of complaints, as government enforcement agencies will look to complaints to establish institutional awareness of problems.

Conclusion

In the current climate of heightened governmental enforcement, regulatory oversight, and increasing class litigation, mortgage servicers must be committed to implementing best practices policies that ensure fair dealing with their loan customers and reduce their exposure to adverse reputational and financial consequences. In the absence of any clear articulation of a best practices industry standard, mortgage servicers are advised to be vigilant in identifying any areas within the company that are in need of improvement by engaging in routine, comprehensive self-analysis that encompasses careful monitoring of potential sources of litigation.