

BANKRUPTCY COMPLIANCE IS SOMETIMES EASIER SAID THAN DONE

A black and white photograph showing a close-up of a person's hand holding a pen, poised to write on a piece of paper. The background is slightly blurred, suggesting an office or courtroom setting.

The bankruptcy system can be complex and confusing for all parties, including for creditors who are thrust into a web of unfamiliar bankruptcy laws and rules. Compliance is always necessary and sometimes difficult. That is why AIS has combined cutting-edge technology with professional oversight to assist clients in navigating the shoals of bankruptcy. In fact, the AIS suite of services is designed to keep creditors out of court by filing the necessary bankruptcy paperwork and ensuring compliance so that creditors can recover money owed to them while respecting the debtors' rights to a fresh start. Even the most conscientious creditors who go it alone in the bankruptcy process can sometimes make inadvertent compliance mistakes. There can be a high cost to non-compliance, including lost recoveries or sanctions by the court. Even worse, creditors who violate bankruptcy laws and rules may suffer significant reputational damage. Following is a list of some of the more prevalent mistakes that creditors sometimes make that should be avoided.

AUTOMATIC STAY

By operation of law, filing a bankruptcy petition creates an automatic stay that prohibits creditors from taking almost any action to collect a debt. Post-petition communications with the debtor or her counsel must be clear that the creditor is not trying to collect on a debt. Although creditors are notified about the filing, the imposition of the stay is instantaneous. Large creditors especially should adopt systems that let them match bankruptcy filings with their customer base to avoid the unpleasant consequences of even inadvertent violations of the stay.

PROOF OF CLAIM

When debtors have sufficient income or assets to repay all or a portion of their just debts (that includes every chapter 13 case and about five percent of chapter 7 cases), creditors generally need to file a proof of claim showing the amount they are owed, the kind of debt they are owed (e.g., credit card, secured auto loan), and the documentation that supports the claim. Bankruptcy Rule 3001(c) sets out the necessary supporting information, but it is not always easy to follow. Importantly, proofs of claim are filed under penalty of perjury. Banks and other creditors that “robo-signed” claims forms without ensuring the signatory took adequate time to examine the supporting documentation have faced extensive discovery, depositions under oath, monetary loss, and third-party monitoring. The Justice Department’s United States Trustee Program (USTP) has periodically tested claims filed by major creditors to identify facial deficiencies that have revealed serious and systemic flaws in creditor accounting and signing procedures. In the past, creditor billing systems that worked for current accounts often failed to accommodate the special accounting rules on permissible interest, fees, and other charges that apply once in bankruptcy. Failure to follow bankruptcy rules in this area has cost creditors hundreds of millions of dollars in court-ordered relief and severe reputational harm.

PERSONALLY IDENTIFIABLE INFORMATION

Although bankruptcy is a very transparent process with a large amount of disclosure of financial information, the law protects personally identifiable information (PII) that might subject the debtor to identity theft, other fraud, and unnecessary invasions of privacy. It is critical that creditors redact personally identifiable information from claims and other documentation filed on the court record. Creditors generally possess the redaction software to

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comply, but they must also train staff to review filings to ensure appropriate redactions are made. All too often, undetected software flaws and inadequate staff training result in privacy breaches that can potentially harm tens of thousands of debtors and their families. Recently, the USTP identified yet another major PII breach by a financial institution. At the very least, the remedies generally require expensive re-filings, notices to affected parties, and credit monitoring. In all areas of modern commerce, data security and protecting PII are important priorities. They are just as crucial in bankruptcy as well.

SPECIAL RULES FOR HOME MORTGAGES IN CHAPTER 13

Saving the family home is often the debtor's primary objective in filing a chapter 13 petition. In addition to all the other rules described herein, creditors are subject to additional rules pertaining to home mortgages. These special rules require noticing of payment changes; fees, expenses, and charges incurred post-petition; and final cure payments. The noticing provides greater transparency, gives the parties an opportunity to object, and allows the court to adjudicate any disputes.

Mortgage servicers are required to provide 21-days advance notice of changes in monthly payments so that homeowners or the USTP may object on the grounds that the increases were not permissible. The failure to provide timely notice of payment changes (or even mortgage modifications) is one of the major violations committed by mortgage servicers. Fees, expenses, and charges incurred post-petition must be itemized and noticed within 180 days after they were incurred.

Similarly, the rule imposes an obligation on mortgage creditors to file a statement at the end of the case testifying that the debtor has paid the amount required to cure any default. This protects the debtor from a catastrophic surprise, such as finding out that, despite five years of making monthly chapter 13 payments, a deficiency remains and the house will be lost to foreclosure after bankruptcy. The Judicial Conference's Advisory Committee on Bankruptcy Rules is considering an additional requirement for a mid-case review so the debtor has an opportunity to make any necessary additional payments during the bankruptcy.

DISCHARGE INJUNCTION

Just as the bankruptcy law imposes an automatic stay at the commencement of the case, the court issues a discharge injunction at the end of the case that lasts forever. Debtors who satisfy their obligations under the law are relieved of personal liability on most or all of their pre-petition debts. Creditors who lack appropriate automated information systems may unknowingly violate the discharge injunction after the bankruptcy case is closed. This sometimes occurs when a debtor files a subsequent bankruptcy case and the creditor's accounting system does not reflect the discharge of the old debt.

Purchasing claims that contain stray discharged debts and taking other actions on older debts can also be hazardous. Courts treat violations of their orders very seriously. Failure to obey the discharge injunction is one of the most egregious acts that a creditor may commit, so creditors need to adopt processes to minimize the risk of a violation.

CONCLUSION

Successfully navigating the bankruptcy system can be a daunting task for many creditors. As seemingly complex as some of the rules appear, their purpose is straight-forward: creditors must file accurate and complete information so that they can be repaid in the amount, priority order, and proportion that the law allows. That sometimes requires expert assistance. Creditors are often disappointed because they are not repaid in full in bankruptcy. That is all the more reason to avoid additional losses of money and reputation and imposition of court-ordered oversight that non-compliance might bring.

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ABOUT THE AUTHOR



CLIFFORD J. WHITE III

Managing Director, Bankruptcy Compliance

Cliff assists clients in effectively administering their portfolios of default loans and implementing systems that meet the highest standards of excellence and legal compliance. For 17 years, White led the United States Trustee Program (USTP), the Department of Justice's "watchdog" of the bankruptcy system. He retired March 2022, after 42 years of federal service. He is the recipient of two Presidential Rank Awards - the highest recognition accorded to senior career executives - by President George W. Bush and President Barack Obama. As Director of the USTP, his accomplishments include the implementation of key provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and the Small Business Reorganization Act of 2019.

ABOUT AIS

AIS is a Texas-based FinTech firm offering data analytics, technology and talent to support Operations and IT functions within the financial services sector. We are committed to lowering costs, improving quality and delivering faster results for our clients. Our insights, software robotics and workforce solutions drive the day-to-day work so our clients can focus on growing their business. Using a lean Six Sigma approach, our team reviews client processes, eliminates non-value adds, and streamlines productivity. We build and share financial and legal technology to automate and optimize workforce performance. We recruit, train and manage highly-skilled human resources to meet project-based or full-time staffing needs. Our clients have access to a global team of subject matter experts specializing in data/analytics, operations automation, loan administration and legal support. We serve a variety of industries including banking, automotive finance, credit card, mortgage, insurance and telecommunications.