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ZERO-BALANCE REPORTING OF MORTGAGE DEBT POST-BANKRUPTCY

The zero-balance approach to reporting post-bankruptcy discharged loans is, with some dissent, the prevailing view required of furnishers by the courts. The authors discuss the majority and minority views, and point out that zero-balance reporting may create inaccuracy when debtors continue to make mortgage payments post-discharge in order to avoid foreclosure. They suggest that the CFPB and the courts reconsider the wholesale zero-balance approach.

By Ryan M. Holz, Irina Dashevsky, and Douglas R. Sargent *

The recent spike in Fair Credit Report Act (FCRA)[1] litigation is undeniable — the number of newly filed FCRA cases has increased from approximately 1,500 in 2007 to nearly 4,000 in 2016.[2] One of the key factors contributing to this rise is the substantial increase in personal bankruptcies filed in the aftermath of the 2008 housing market crash and subsequent recession.[3]

Although bankruptcy filings have now receded to their pre-recession levels, the surge in filings and subsequent discharges have resulted in more frequent clashes between debtors and furnishers of information (oftentimes lenders and servicers of residential mortgage loans) regarding post-discharge reporting. Those clashes are ongoing.

Generally speaking, when a debtor with a consumer loan secured by a mortgage on real property files for bankruptcy and receives a discharge, there are three primary dispositions for the loan and the property. Some debtors reaffirm their obligation under the loan in the bankruptcy proceedings, so the loan is unaffected by the bankruptcy discharge. Other debtors abandon the property as part of the bankruptcy proceedings (often referred to as "surrendering the property") and allow the lender to take title to the property, through foreclosure or otherwise, without objection (either pre- or post-discharge). A third set of debtors obtain a discharge of their personal liability on the loan, but remain in the

[1] 15 U.S.C. §§ 1681 *et seq*.

[2] https://webrecon.com/2016-year-in-review-fdcpa-down-fcra-tcpa-up/ (last visited August 30, 2017).

[3] Personal bankruptcies increased from 934,009 in 2008 to 1,512,989 in 2010. U.S. Courts Website, http://www.uscourts.gov/news/2012/08/03/bankruptcy-filings-continue-decline (last visited August 30, 2017). Although personal bankruptcies have now returned to below their pre-recession levels (*id*.), FCRA claims arising from those bankruptcies are a lagging indicator because debtors do not generally file FCRA actions until their bankruptcy proceedings are complete.

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property and continue to make voluntary monthly mortgage payments post-discharge. Their lenders, in turn, typically forbear from exercising the right to foreclose and liquidate the real property asset. This article focuses on this third category and recommends that the Consumer Financial Protection Bureau (CFPB) and the courts take another look at post-discharge reporting practices in this scenario, particularly the prevailing practice of "zeroing out" loan balances post-discharge.

I. THE PREVAILING VIEW OF POST-DISCHARGE REPORTING — ZERO BALANCE FOR DISCHARGED LOANS.

The FCRA itself does not provide specific guidance on how a furnisher of information should report a post-discharge loan. The FCRA generally permits consumer reporting agencies to report debts for seven years after a bankruptcy discharge, which establishes that furnishers can continue to provide some information about discharged loans.[4] But the statutory scheme's guidance stops there; there is nothing that details what the furnisher can or must report. Instead, furnishers are vaguely directed to ensure that they "provide accurate information" as to the status of the account.[5]

The gap in the statutory scheme was partially filled by the Federal Trade Commission (FTC) in 1990, when it had responsibility for FCRA rulemaking. The FTC advised furnishers that "[a] consumer report may include an account that was discharged in bankruptcy (as well as the bankruptcy itself), ***as long as it reports a zero balance due*** to reflect the fact that the consumer is no longer liable for the discharged debt."[6] Courts generally relied on that guidance and held that to report a post-discharge loan accurately, a furnisher must report a zero balance.[7]

The viability of the FTC's "zero-balance" commentary was placed in doubt when the Dodd-Frank Act transferred FCRA rulemaking from the FTC to the newly created CFPB. In the last seven years, the CFPB has not formally ratified the FTC's "zero-balance" directive. But the CFPB also has not replaced it. Accordingly, many courts throughout the country have continued to rely on the FTC commentary when adjudicating post-discharge FCRA claims.[8]

II. THE MINORITY VIEW OF POST-DISCHARGE REPORTING — NO ZERO BALANCE REQUIRED.

The "zero-balance" approach has not been universally adopted. In *Riekki v. Bayview Loan Financial Servicing*, Bayview failed to reduce a post-discharge debt to zero and Riekki brought suit under the FCRA.[9] The district court of Nevada rejected Riekki's contention that Bayview's furnishing was false and misleading and dismissed the action, relying on section 1681c of the FCRA.[10] The district court reasoned that if section 1681c explicitly allows for reporting of a discharged

[4] 15 U.S.C. § 1681c.

[5] 15 U.S.C. § 1681s-2(a).

[6] 16 C.F.R. 600 App. § 607(b)(6) (emphasis added).

[7] *See, e.g., In re Helmes*, 336 B.R. 105, 109 (Bankr. E.D. Va. 2005) (holding that furnishers of information may be in violation of a bankruptcy discharge injunction unless "a debt discharged in bankruptcy [is] reported to a credit reporting

footnote continued from previous column…

agency with the notation 'Discharged in bankruptcy' and with a zero balance due"); *In re Zombro*, No. 06–1166, 2008 WL 1752211, *6 (E.D. Va. April 14, 2008) ("The court will grant an injunction requiring the bank to correct the reports so that they show that the Mortgage Debt as 'Discharged in Bankruptcy' with a date of last activity of June 1997, and a zero balance due.").

[8] *See, e.g., Mortimer v. Bank of America*, No. C–12–01959 JCS, 2013 WL 1501452, *10 (N.D. Cal. Apr. 10, 2013) ("To avoid presenting a misleading picture, the creditor must also report that the account was discharged through the bankruptcy and the outstanding balance on that account is zero."); *Hupfauer v. Citibank, N.A.*, No. 16 C 475, 2016 WL 4506798, *5 (N.D. Ill. Aug. 19, 2016) (holding that a zero balance should be reported after a bankruptcy discharge, but that alone is not sufficient to avoid inaccurate reporting under the FCRA); *Twomey v. Ocwen Loan Servicing, LLC*, No. 16-cv-0918, 2016 WL 4429895, *4 (N.D. Ill. Aug. 22, 2016) ("Credit Reporting Agencies are not prohibited from reporting a debt that was discharged in bankruptcy so long as the balance amount is corrected to zero.").

[9] *Riekki v. Bayview Loan Financial Servicing*, No. 2:15–CV–2427 JCM (GWF), 2016 WL 4083216, *2 (D. Nev. Jul. 28, 2016).

[10] *Id*.

debt for seven years, then reporting the pre-discharge balance (*i.e.*, not zeroing out the balance) could not be false or misleading.[11] The district court did not mention the FTC's "zero-balance" directive that has animated the decisions of courts throughout the country.

Although the *Riekki* court did not directly address, let alone reject, the "zero-balance" approach, it did shine light on the fact that there is no explicit statutory authority for that approach. All that the FCRA requires is accuracy, and there is a plausible argument that denoting the pre-discharge balance due with an indicator that the debt has been discharged in bankruptcy is as accurate (or perhaps more accurate) than zeroing out the balance due. When combined with the explicit allowance for post-discharge reporting of bankruptcies set forth in section 1681c of the FCRA, there is a plausible basis for the district court of Nevada's *Riekki* decision.

III. THE "ZERO-BALANCE" APPROACH ACTUALLY CREATES INACCURACY

There is another problem with the "zero-balance" approach that *Riekki* does not discuss, but that has begun to crop up in court decisions throughout the country. As mentioned above, some debtors receive a discharge in bankruptcy (thus extinguishing any personal liability), but remain in the property and continue making monthly payments to their lenders. In response, their lenders often forbear from exercising their right to foreclose on the property. This causes a conundrum for furnishers of information — how should they report those post-discharge payments to the consumer reporting agencies?

Debtors have taken the position that, in the name of accuracy, furnishers must report the post-discharge payments. Furnishers, in turn, have taken the position that if they are required to "zero out" the loan balance per the FTC's commentary and/or the majority view from courts, it does not make sense to report post-discharge payments. After all, if there is no balance, there is no debt to pay.

Courts have uniformly sided with the furnishers on that question. *Schueller v. Wells Fargo & Co.* presented the typical fact pattern — Schueller obtained a bankruptcy discharge and continued to make payments to avoid foreclosure, but Wells Fargo did not report those payments, instead reporting that the loan was closed and discharged in bankruptcy.[12] Schueller claimed that "the credit report should not have reflected that his account was closed and had a zero balance due, and should have included the fact that he made [post-discharge] payments…"[13] The Tenth Circuit summarily rejected that argument, concluding that Schueller "cited no authority requiring Wells Fargo to report his post-bankruptcy mortgage payments" and thus failed to establish that Wells Fargo's credit reporting was inaccurate, incomplete, or misleading.[14]

If we assume that it is appropriate to "zero out" the balance due, it is clear that the courts have reached the correct decision in rejecting the claims of debtors regarding the reporting of post-discharge payments. It simply would not make sense to report an account with a zero balance and then report continuing monthly payments on that purportedly closed account. That would lead to widespread confusion.

But it is equally clear that the "zero-balance" approach (and the necessary consequence of that approach that post-discharge payments are not being reported) creates its own inaccuracy. Instead of accurately reflecting the reality of the situation — personal liability has been extinguished by the bankruptcy discharge, the loan remains unpaid and secured by real property, and the debtor is making monthly payments to avoid foreclosure — the "zero-balance" approach creates the illusion that the loan has simply disappeared after discharge. That is not only incorrect, but it is potentially harmful in that it creates a

[11] *Id.*; *see also Abeyta v. Bank of Am., N.A.*, No. 2:15-cv-02320-RCJ-NJK, 2016 WL 304308, *2 (D. Nev. Jan. 25, 2016) (same).

[12] *Schueller v. Wells Fargo & Co.*, 559 Fed. Appx. 733, 734-35 (10th Cir. 2014).

[13] *Id*. at 737.

[14] *Id.*; *see also Horsch v. Wells Fargo Home Mortg.*, 94 F. Supp. 3d 665, 674 (E.D. Pa. 2015) (relying on *Schueller* and dismissing a post-discharge FCRA claim; "the court agreed that Schueller's making payments on the mortgage to prevent foreclosure did not mean that he truly owed anything on the discharged account. Reporting a 'zero balance' was, therefore, accurate and complete. I agree with this reasoning."); *Groff v. Well Fargo Home Mortg., Inc.*, 108 F. Supp. 3d 537, 541 (E.D. Mich. 2015) ("There was nothing false or 'inaccurate' about the bank's reporting of the mortgage loan account as closed, with a zero balance. The plaintiff does not dispute that his personal obligation to pay the note was discharged by his bankruptcy, and he does not contend that Wells Fargo ever made any effort to compel him to make further payments, or that he would have had any obligation to do so if it had. The debt was eliminated, and the bank reported it as such.").

misleading picture for future lenders and prevents debtors from taking early steps to rehabilitate their credit. It also marginally disincentivizes debtors from making post-discharge payments in an effort to keep their home.

IV. WHAT NOW? THE CFPB AND COURTS SHOULD RECONSIDER THE "ZERO-BALANCE" APPROACH.

And that begs the question — if the goal of the FCRA is accuracy and the "zero-balance" approach fosters inaccuracy (at least when debtors are continuing to make post-discharge payments), should that approach be reconsidered? We believe it should.

For one, the time is ripe. Dodd-Frank transferred rulemaking authority for the FCRA from the FTC to the CFPB, and the CFPB has not yet issued its own guidance on the "zero-balance" issue. It could easily do so now and push courts in that direction.

But more importantly, the minority-view *Riekki* approach appears to fit better with the FCRA's focus on accuracy. Under that approach, furnishers could continue to report the balance due on the loan after discharge as long as they also report that the personal liability is discharged. Then, if the debtor makes a post-discharge payment, that payment can be reflected to reduce the post-discharge balance securing the property. This would give future prospective lenders a clearer picture of what has actually happened post-discharge, while giving debtors both an incentive to make post-discharge payments to keep their home and begin rehabilitating their credit.

Like anything else, there are potential pitfalls with the *Riekki* approach that the CFPB and courts would need to grapple with. For instance, including the pre-discharge balance, even with an indicator for the discharge, may lead to confusion, with debtors being denied credit based on the mistaken assumption that they remain liable for a discharged debt. That appears to have been part of the initial impetus for the "zero-balance" rule,[15] but it is not clear that fear is justified. Another issue is how furnishers of information report "missed" post-discharge payments. In other words, if a debtor made five post-discharge payments, but then failed to make a sixth, how should the furnisher denote that in its consumer reporting? A furnisher would not want to report the missed payment in a disparaging fashion; after-all, the post-discharge payments are voluntary and the debtor has no personal liability. But at the same time, the reporting could easily become misleading if all that was being reported were the voluntary payments ***made***, with no credit reporting consequences for those payments that were ***missed***.

Nevertheless, those issues and others that are sure to arise are at least worth looking into. What the CFPB and courts should not do is allow inertia to dictate adherence to the FTC's nearly 30-year-old "zero-balance" model, without thoughtful consideration as to whether that model presents the most accurate picture for both lenders and debtors. ■

[15] *See, e.g., Twomey*, 2016 WL 4429895 at *4 ("even if we were to assume that the information in the credit report indicating the balance and past due amount of $182,542.00 were technically accurate, a reader of the report could be misled into thinking that Plaintiff still personally owed this obligation (or, at a minimum, be confused as to this point)….").