**CONGRESSIONAL WRITTEN REPORT REGARDING**

**SECURITIZATION AND FRAUDCLOSURE OF NOVEMBER 18, 2010**

Testimony in a New Jersey bankruptcy court case provides proof of the scenario we’ve depicted,

that subprime originators, starting sometime in the 2004-2005 timeframe, if not earlier, stopped

conveying note (the borrower IOU) to mortgage securitization trust as stipulated in the pooling

and servicing agreement. Professor Adam Levitin in his testimony before the House Financial

Services Committee last week described what the implications would be:

If mortgages were not properly transferred in the securitization process, then mortgage-backed

securities would in fact not be backed by any mortgages whatsoever. The chain of title concerns

stem from transactions that make assumptions about the resolution of unsettled law. If those

legal issues are resolved differently, then there would be a failure of the transfer of mortgages

into securitization trusts, which would cloud title to nearly every property in the United States

and would create contract rescission/putback liabilities in the trillions of dollars, greatly

exceeding the capital of the US’s major financial institutions….

Recently, arguments have been raised in foreclosure litigation about whether the notes and

mortgages were in fact properly transferred to the securitization trusts. This is a critical issue

because the trust has standing to foreclose if, and only if it is the mortgagee. If the notes and

mortgages were not transferred to the trust, then the trust lacks standing to foreclose…

If the notes and mortgages were not properly transferred to the trusts, then the mortgage-backed

securities that the investors’ purchased were in fact non-mortgage-backed securities. In such a

case, investors would have a claim for the rescission of the MBS, meaning that the securitization

would be unwound, with investors receiving back their original payments at par (possibly with

interest at the judgment rate). Rescission would mean that the securitization sponsor would have

the notes and mortgages on its books, meaning that the losses on the loans would be the

securitization sponsor’s, not the MBS investors, and that the securitization sponsor would have

to have risk-weighted capital for the mortgages. If this problem exists on a wide-scale, there is

not the capital in the financial system to pay for the rescission claims; the rescission claims

would be in the trillions of dollars, making the major banking institutions in the United States

would be insolvent.

Countrywide, and likely many other subprime originators quit conveying the notes to the

securitization trusts sometime in the 2004-2005 time frame. Yet bizarrely, they did not change

the pooling and servicing agreements to reflect what appears to be a change in industry practice.

Our evidence of this change was strictly anecdotal; this bankruptcy court filing, posted at

StopForeclosureFraud provides the first bit of concrete proof. The key section:

As to the location of the note, Ms. DeMartini testified that to her

knowledge, the original note never left the possession of Countrywide, and that

the original note appears to have been transferred to Countrywide’s foreclosure

unit, as evidenced by internal FedEx tracking numbers. She also confirmed

that the new allonge had not been attached or otherwise affixed to the note.

She testified further that it was customary for Countrywide to maintain possession of

the original note and related loan documents.

This is significant for two reasons: first, it points to pattern and practice, and not a mere isolated

lapse. Second, Countrywide, the largest subprime originator, reported in SEC filings that it

securitized 96% of the loans it originated. So this activity cannot be defended by arguing that

Countrywide retained notes because it was not on-selling them; the overwhelming majority of its

mortgage notes clearly were intended to go to RMBS trusts, but it appears industry participants

came to see it as too much bother to adhere to the commitments in their contracts.

“Whenever we’ve gotten into situations on the short side, no matter how bad we think it is, it

always proven to be worse.” The mortgage securitization mess looks to be adhering to this script.

*GEORGETOWN UNIVERSITY LAW CENTER*

***Adam J. Levitin***

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**Written Testimony of**

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**Associate Professor of Law**

**Georgetown University Law Center**

Before the

House Financial Services Committee

Subcommittee on Housing and Community Opportunity

“Robo-Singing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing”

November 18, 2010

10:00 am

**Witness Background Statement**

**Adam J. Levitin** in an Associate Professor of Law at the Georgetown University Law

Center, in Washington, D.C., and Robert Zinman Scholar in Residence at the American

Bankruptcy Institute. He also serves as Special Counsel to the Congressional Oversight Panel

and has been the Robert Zinman Scholar in Residence at the American Bankruptcy Institute.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business

Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served

as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third

Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from

Columbia University, and an A.B. from Harvard College.

Professor Levitin has not received any Federal grants nor has he received any

compensation in connection with his testimony. The views expressed in Professor Levitin’s

testimony are his own and do not represent the positions of the Congressional Oversight Panel.

**EXECUTIVE SUMMARY**

The US is now in its forth year of a mortgage crisis in which over 3 million families have

lost their homes and another 2.5 million are currently scheduled to lose theirs. Repeated

government loan modification or refinancing initiatives have failed miserably. To this sad state

of affairs, there now come a variety of additional problems: faulty foreclosures due to

irregularities ranging from procedural defects (including, but not limited to robosigning) to

outright counterfeiting of documents; predatory servicing practices that precipitate borrower

defaults and then overcharge for foreclosure services that are ultimately paid for by investors;

and questions about the validity of transfers in private-label mortgage securitizations. While the

extent of these problems is unknown at present, the evidence is mounting that they are not

limited to one-off cases, but that there may be pervasive defects throughout the mortgage

servicing and securitization processes.

The servicing problems stem from servicers’ failed business model. Servicers are

primarily in the transaction processing business and are failing miserably at trying to adapt

themselves to the loan modification business. Servicers’ business model also encourages them to

cut costs wherever possible, even if this involves cutting corners on legal requirements, and to

lard on junk fees and in-sourced expenses at inflated prices. The financial incentives of mortgage

servicers also encourage them to foreclose, rather than modify loans in many cases, even when

modification would maximize the net present value of the loan for investors.

The chain of title problems are highly technical, but they pose a potential systemic risk to the US

economy. If mortgages were not properly transferred in the securitization process, then

mortgage-backed securities would in fact not be backed by any mortgages whatsoever. The chain

of title concerns stem from transactions that make assumptions about the resolution of unsettled

law. If those legal issues are resolved differently, then there would be a failure of the transfer of

mortgages into securitization trusts, which would cloud title to nearly every property in the

United States and would create contract rescission/putback liabilities in the trillions of dollars,

greatly exceeding the capital of the US’s major financial institutions.

These problems are very serious. At best they present problems of fraud on the court,

clouded title to properties coming out of foreclosure, and delay in foreclosures that will increase

the shadow housing inventory and drive down home prices. At worst, they represent a systemic

risk that would bring the US financial system back to the dark days of the fall of 2008.

Congress would do well to ensure that federal regulators are undertaking a thorough

investigation of foreclosure problems and to consider the possibilities for a global settlement of

foreclosure problems, loan modifications, and the housing debt overhang on consumers and

financial institutions that stagnate the economy and pose potential systemic risk.

**TESTIMONY**

Madam Chairwoman, Members of the Committee:

Good morning. My name is Adam Levitin. I am an Associate Professor of Law at the

Georgetown University Law Center in Washington, D.C., where I teach courses in bankruptcy,

commercial law, contracts, and structured finance. I also serve as Special Counsel to the

Congressional Oversight Panel for the Troubled Asset Relief Program. The views I express today

are my own, however.

We are now well into the fourth year of the foreclosure crisis, and there is no end in sight.

Since mid-2007 around eight million homes entered foreclosure,1 and over three million

borrowers lost their homes in foreclosure.2 As of June 30, 2010, the Mortgage Bankers

Association reported that 4.57% of 1-4 family residential mortgage loans (roughly 2.5 million

loans) were currently in the foreclosure, process a rate more than quadruple historical averages.

Additionally, 9.85% of mortgages (roughly 5 million loans) were at least a month delinquent.3

**Percentage of 1-4 Family Residential Mortgages in Foreclosure4**

Private lenders, industry associations, and two successive administrations have made a

variety of efforts to mitigate the crisis and encourage loan modifications and refinancings. A

series of much hyped initiatives, such as the FHASecure refinancing program and the

Hope4Homeowners have all met what can charitably be described as limited success.

FHASecure, predicted to help 240,000 homeowners,5 assisted only a few thousand borrowers

1 HOPE Now Data Reports.

2 *Id.*

3 Mortgage Bankers Association, National Delinquency Survey.

4 Mortgage Bankers Association, National Delinquency Surveys.

5 *See, e.*g., Press Release, US Dep’t of Housing and Urban Development, Bush Administration to Help Nearly One-Quarter of a

Million Homeowners Refinance, Keep Their Homes; FHA to implement new “FHASecure” refinancing product (Aug. 31, 2007), *available at*

http://www.hud.gov/news/release.cfm?content=pr07-123.cfm; Press Release, US Dep’t of Housing and Urban Development, FHA Helps 400,000

Families Find Mortgage Relief; Refinancing on pace to help half-million homeowners by year’s end (Oct. 24, 2008), *available at*

http://www.hud.gov/news/release.cfm?content=pr08- 167.cfm.

before it wound down,6 while Hope4 Homeowners, originally predicted to help 400,000

homeowners,7 had closed only 130 refinancings as of September 30, 2010.8 The Home

Affordable Modification (HAMP) has also failed, producing 495,898 permanent modifications

through September 2010. This number is likely to be a high water mark for HAMP, as new

permanent modifications are decreasing rapidly while defaults on permanent modifications rise;

if current trends continue, by year’s end the number of active permanent HAMP modifications

will actually decline.

A number of events over the past several months have roiled the mortgage world, raising

questions about:

**(1)** Whether there is widespread fraud in the foreclosure process;

**(2)** Securitization chain of title, namely whether the transfer of mortgages in the

securitization process was defective, rendering mortgage-backed securities into *non*-mortgagebacked

securities;

**(3)** Whether the use of the Mortgage Electronic Registration System (MERS) creates

legal defects in either the secured status of a mortgage loan or in mortgage assignments;

**(4)** Whether mortgage servicers’ have defaulted on their servicing contracts by charging

predatory fees to borrowers that are ultimately paid by investors;

**(5)** Whether investors will be able to “putback” to banks securitized mortgages on the

basis of breaches of representations and warranties about the quality of the mortgages.

These issues are seemingly disparate and unconnected, other than that they all involve

mortgages. They are, however, connected by two common threads: the necessity of proving

standing in order to maintain a foreclosure action and the severe conflicts of interests between

mortgage servicers and MBS investors.

It is axiomatic that in order to bring a suit, like a foreclosure action, the plaintiff must

have legal standing, meaning it must have a direct interest in the outcome of the litigation. In the

case of a mortgage foreclosure, only the mortgagee has such an interest and thus standing. Many

of the issues relating to foreclosure fraud by mortgage servicers, ranging from more minor

procedural defects up to outright counterfeiting relate to the need to show standing. Thus

problems like false affidavits of indebtedness, false lost note affidavits, and false lost summons

affidavits, as well as backdated mortgage assignments, and wholly counterfeited notes,

mortgages, and assignments all relate to the evidentiary need to show that the entity bringing the

foreclosure action has standing to foreclose.

Concerns about securitization chain of title also go to the standing question; if the

mortgages were not properly transferred in the securitization process (including through the use

of MERS to record the mortgages), then the party bringing the foreclosure does not in fact own

the mortgage and therefore lacks standing to foreclose. If the mortgage was not properly

transferred, there are profound implications too for investors, as the mortgage-backed securities

they believed they had purchased would, in fact be non-mortgage-backed securities, which

6 Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J.,, Dec. 31, 2008.

7 Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure*, WASH. POST. Dec. 17, 2008, at A1.

8 *See* FHA Single Family Outlook, Sept. 2010, *at* http://www.hud.gov/offices/hsg/rmra/oe/rpts/ooe/olcurr.xls - 2010-11-02, Row 263

(note that FHA fiscal years begin in October, so that Fiscal Year 2009 began in October 2008).

3

would almost assuredly lead investors to demand that their investment contracts be rescinded,

thereby exacerbating the scale of mortgage putback claims.

Putback claims underscore the myriad conflicts of interest between mortgage servicers

and investors. Mortgage servicers are responsible for prosecuting on behalf of MBS investors,

violations of representations and warranties in securitization deals. Mortgage servicers are loathe

to bring such actions, however, not least because they would often be bringing them against their

own affiliates. Servicers’ failure to honor their contractual duty to protect investors’ interest is

but one of numerous problems with servicer conflicts of interest, including the levying of junk

fees in foreclosures that are ultimately paid by investors and servicing first lien loans while

directly owning junior liens.

Many of the problems in the mortgage securitization market (and thus this testimony) are highly

technical, but they are extremely serious.9 At best they present problems of fraud on the court

and questionable title to property. At worst, they represent a systemic risk of liabilities in the

trillions of dollars, greatly exceeding the capital of the US’s major financial institutions.

While understanding the securitization market’s problems involves following a good deal of

technical issues, it is critical to understand from the get-go that securitization is all about

technicalities.

Securitization is the legal apotheosis of form over substance, and if securitization is to

work it must adhere to its proper, prescribed form punctiliously. The rules of the game with

securitization, as with real property law and secured credit are, and always have been, that

dotting “i’s” and crossing “t’s” matter, in part to ensure the fairness of the system and avoid

confusions about conflicting claims to property. Close enough doesn’t do it in securitization; if

you don’t do it right, you cannot ensure that securitized assets are bankruptcy remote and thus

you cannot get the ratings and opinion letters necessary for securitization to work. Thus, it is

important not to dismiss securitization problems as merely “technical;” these issues are no more

technicalities than the borrower’s signature on a mortgage. Cutting corners may improve

securitization’s economic efficiency, but it undermines its legal viability.

Finally, as an initial matter, let me also emphasize that the problems in the securitization

world do not affect the whether homeowners owe valid debts or have defaulted on those debts.

Those are separate issues about which there is no general controversy, even if debts are disputed

in individual cases.10

This written testimony proceeds as follows: Part I presents an overview of the structure

of the mortgage market, the role of mortgage servicers, the mortgage contract and foreclosure

process.

Part II presents the procedural problems and fraud issues that have emerged in the

mortgage market relating to foreclosures.

Part III addresses chain of title issues.

Part IV considers the argument that the problems in foreclosures are mere technicalities being

used by deadbeats to delay foreclosure.

Part V concludes.

9 I emphasize, however, that this testimony does not purport to be a complete and exhaustive treatment of the issues involved and that

many of the legal issues discussed are not settled law, which is itself part of the problem; trillions of dollars of mortgage securitization

transactions have been done without a certain legal basis.

10 A notable exception, however, is for cases where the default is caused by a servicer improperly force-placing insurance or

misapplying a payment, resulting in an inflated loan balance that triggers a homeowner default.

**I. BACKGROUND ON SECURITIZATION, SERVICING, AND THE FORECLOSURE PROCESS**

***A. MORTGAGE SECURITIZATION***

Most residential mortgages in the United States are financed through securitization.

Securitization is a financing method involving the issuance of securities against a dedicated

cashflow stream, such as mortgage payments, that are isolated from other creditors’ claims.

Securitization links consumer borrowers with capital market financing, potentially lowering the

cost of mortgage capital. It also allows financing institutions to avoid the credit risk, interest rate

risk, and liquidity risk associated with holding the mortgages on their own books.

Currently, about 60% of all outstanding residential mortgages by dollar amount are

securitized.11

The share of securitized mortgages by number of mortgages outstanding is much

higher because the securitization rate is lower for larger “jumbo” mortgages.12

Credit Suisse

estimates that 75% of outstanding first-lien residential mortgages are securitized.13

In recent

years, over 90% of mortgages originated have been securitized.14

Most second-lien loans,

however, are not securitized.15

Although mortgage securitization transactions are extremely complex and vary somewhat

depending on the type of entity undertaking the securitization, the core of the transaction is

relatively simple.16

First, a financial institution (the “sponsor” or “seller”) assembles a pool of mortgage

loans. The loans were either made (“originated”) by an affiliate of the financial institution or

purchased from unaffiliated third-party originators. Second, the pool of loans is sold by the

sponsor to a special-purpose subsidiary (the “depositor”) that has no other assets or liabilities.

This is done to segregate the loans from the sponsor’s assets and liabilities.17

Third, the

depositor sells the loans to a passive, specially created, single-purpose vehicle (SPV), typically a

trust in the case of residential mortgages.18

The SPV issues certificated securities to raise the

funds to pay the depositor for the loans. Most of the securities are debt securities—bonds—but

there will also be a security representing the rights to the residual value of the trust or the

“equity.”

11 Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

12 *Id.*

13 Ivy L. Zelman et al., *Mortgage Liquidity du Jour: Underestimated No More* 28 exhibit 21 (Credit Suisse, Equity Research Report,

Mar. 12, 2007).

14 Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual.

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Inside Mortgage Finance, 2010 Mortgage Market Statistical Annual. From 2001-2007, only 14% of second lien mortgages

originated were securitized. *Id.* Second lien mortgages create a conflict of interest beyond the scope of this paper. In many cases, second lien

loans are owned by financial institutions that are servicing (but do not own) the first lien loan. *See* Hearing Before the House Financial Services

Committee, Apr. 13, 2009 “Second Liens and Other Barriers to Principal Reduction as an Effective Foreclosure Mitigation Program” (testimony

of Barbara DeSoer, President, Bank of America Home Loans) at 6 (noting that Bank of America owns the second lien mortgage on 15% of the

first lien mortgages it services); Hearing Before the House Financial Services Committee, Apr. 13, 2009 “Second Liens and Other Barriers to

Principal Reduction as an Effective Foreclosure Mitigation Program” (testimony of David Lowman, CEO for Home Lending, JPMorgan Chase)

at 5 (noting that Chase owns the second lien mortgage on around 10% of the first lien mortgages it services). The ownership of the second while

servicing the first creates a direct financial conflict between the servicer qua servicer and the servicer qua owner of the second lien mortgage, as

the servicer has an incentive to modify the first lien mortgage in order to free up borrower cashflow for payments on the second lien mortgage.

16 The structure illustrated is for private-label mortgage-backed securities. Ginnie Mae and GSE securitizations are structured

somewhat differently. The private-label structure can, of course, be used to securitize any asset, from oil tankers to credit card debt to song

catalogues, not just mortgages.

17 This intermediate entity is not essential to securitization, but since 2002, Statement of Financial Accountings Standards 140 has

required this additional step for off-balance-sheet treatment because of the remote possibility that if the originator went bankrupt or into

receivership, the securitization would be treated as a secured loan, rather than a sale, and the originator would exercise its equitable right of

redemption and reclaim the securitized assets. Deloitte & Touche, *Learning the Norwalk Two-Step*, HEADS UP , Apr. 25, 2001, at 1.

18 The trustee will then typically convey the mortgage notes and security instruments to a “master document custodian,” who

manages the loan documentation, while the servicer handles the collection of the loans.

The securities can be sold directly to investors by the SPV or, as is more common, they

are issued directly to the depositor as payment for the loans. The depositor then resells the

securities, usually through an underwriting affiliate that then places them on the market.

The depositor uses the proceeds of the securities sale (to the underwriter or the

market) to pay the sponsor for the loans. Because the certificated securities are collateralized by

the residential mortgage loans owned by the trust, they are called residential mortgage-backed

securities (RMBS).

A variety of reasons—credit risk (bankruptcy remoteness), off-balance sheet accounting

treatment, and pass-through tax status (typically as a REMIC19

or grantor trust)—mandate that

the SPV be passive; it is little more than a shell to hold the loans and put them beyond the reach

of the creditors of the financial institution.20

Loans, however, need to be managed. Bills must be

sent out and payments collected. Thus, a third-party must be brought in to manage the loans.21

This third party is the servicer. The servicer is supposed to manage the loans for the benefit of

the RMBS holders.

Every loan, irrespective of whether it is securitized, has a servicer. Sometimes that

servicer is a first-party servicer, such as when a portfolio lender services its own loans. Other

times it is a third-party servicer that services loans it does not own. All securitizations involve

third-party servicers, but many portfolio loans also have third-party servicers, particularly if they

go into default. Third-party servicing contracts for portfolio loans are not publicly available,

making it hard to say much about them, including the precise nature of servicing compensation

arrangements in these cases or the degree of oversight portfolio lenders exercise over their thirdparty

servicers. Thus, it cannot always be assumed that if a loan is not securitized it is being

serviced by the financial institution that owns the loan, but if the loan is securitized, it has

thirdparty

servicing.

Securitization divides the beneficial ownership of the mortgage loan from legal title to

the loan and from the management of the loans. The SPV (or more precisely its trustee) holds

legal title to the loans, and the trust is the nominal beneficial owner of the loans. The RMBS

investors are formally creditors of the trust, not owners of the loans held by the trust.

The economic reality, however, is that the investors are the true beneficial owners. The

trust is just a pass-through holding entity, rather than an operating company. Moreover, while the

trustee has nominal title to the loans for the trust, it is the third-party servicer that typically

exercises legal title in the name of the trustee. The economic realities of securitization do not

track with its legal formalities; securitization is the apotheosis of legal form over substance, but

punctilious respect for formalities is critical for securitization to work.

Mortgage servicers provide the critical link between mortgage borrowers and the SPV

and RMBS investors, and servicing arrangements are an indispensable part of securitization.22

Mortgage servicing has become particularly important with the growth of the securitization

market.

19 A REMIC is a real estate mortgage investment conduit, as defined under I.R.C. §§ 860A-860G.

20 *See* Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage Backed*

*Securities*, 82 S. CAL. L. REV. 1075, 1093-98. (2009).

21 *See* Kurt Eggert, *Limiting Abuse and Opportunism by Mortgage Servicers*, 15 HOUSING POL’Y DEBATE 753, 754 (2004).

22 The servicing of nonsecuritized loans may also be outsourced. There is little information about this market because it does not

involve publicly available contracts and does not show up in standard data.

***B. THE MORTGAGE SERVICING BUSINESS*24**

The nature of the servicing business in general militates toward economies of scale and

automation. Servicing combines three distinct lines of business: transaction processing, default

management, and loss mitigation. Transaction processing is a highly automatable business,

characterized by large economies of scale. Default management involves collections and

activities related to taking defaulted loans through foreclosure. Like transaction processing,

23 *See* ACE Sec. Corp. Home Equity Loan Trust, Series 2006-NC3, Prospectus Supplement (Form 424B5) S-11 (Nov. 21, 2006),

*available at* http://www.sec.gov/Archives/edgar/data/1380884/000114420406049985/v058926\_424b5.htm.

24 This section of my testimony comes from Adam J. Levitin & Larry Cordell, *What RMBS Servicing Can Learn from CMBS*

*Servicing*, working paper, November 2010.

default management can be automated,25 as it does not require any negotiation with the

homeowner, insurers, or junior lienholders.26

Loss mitigation is considered an *alternative to foreclosure*, and includes activities such as

repayment plans, loan modifications, short sales and deeds in lieu of foreclosure. Loss mitigation

is always a negotiated process and is therefore labor-intensive and expensive. Not only must the

homeowner be agreeable to any loss mitigation solution, but so too must mortgage insurers and

junior lienholders if they are parties on the loan. Because each negotiation is separate and

requires a trained employee, there are very few opportunities for automation or economies of

scale. Labor expenses are also considered overhead, which are all non-reimbursable expenses to

servicers. And, to the extent that loss mitigation is in the form of a loan modification, re-default

and self-cure risk always lurk in the background. Moreover, loss mitigation must generally be

conducted in addition to default management; the servicer must proceed with foreclosure even if

attempting to find an alternative, so the cost of loss mitigation is additive. Yet, while taking a

loan through foreclosure is likely to involve lower costs than pursuing loss mitigation, it may not

ultimately maximize value for RMBS investors because loss severities in foreclosure can easily

surpass those on a re-performing restructured loan.

The balance between these different parts of a servicer’s business changes over the

course of the housing cycle. When the housing market is strong, the transaction processing

dominates the servicing business, but when the housing market is weak, default management and

loss mitigation become more important.

The very short weighted average life (WAL) of RMBS trusts combined with very low

defaults in most economic environments encouraged servicers to place disproportionate weight

on performing loan servicing, which historically has been characterized by small servicing fees

and enormous economies of scale. Thus, on a typical loan balance of $200,000 today, a servicer

might earn between $500 and $1,000 per year.27 Given the low-level of annual income per loan,

the short WAL of each loan, and low default rates in most economic environments before 2006,

servicers had few incentives to devote resources to loss mitigation, but large incentives to invest

in performing loan automation to capture the large economies of scale. This left servicers wholly

unprepared for the elevated level of defaults that began in 2007.

***C. RMBS SERVICER COMPENSATION***

RMBS servicers’ duties and compensation are set forth in a document called a “Pooling

and Servicing” agreement (PSA) also governs the rights of the RMBS certificate holders. RMBS

servicers are compensated in four ways. First, they receive a “servicing fee,” which is a flat fee

of 25—50 basis points (bps) and is a first priority payment in the RMBS trust.28 This is by far the

greatest portion of servicer income. This fee is paid out proportionately across all loans

regardless of servicer costs through the economic cycle.

25 *See In re Taylor,* 407 B.R. 618 (Bankr. E.D. Pa. 2009), *rev’d* 2010 WL 624909 (E.D. Pa. 2010).

26 Arguably servicers have a fourth line of business—the management of real estate owned (REO). REO are foreclosed properties that

were not purchased by third-parties at the foreclosure sale. REO management involves caring for and marketing the REO. It does not require

negotiations with the homeowner (who is evicted) or junior lienholders (whose liens are generally extinguished by the foreclosure).

27 Servicing fees are generally 25—50 bps, which translates into $500--$1000 per year in servicing fees.

28 Generally the servicing fee is 25 bps for conventional fixed rate mortgages, 37.5 bps for conventional ARM loans, 44 bps for

government loans and 50 bps for subprime.

Second, servicers earn “float” income. Servicers generally collect mortgage payments at

the beginning of the month, but are not required to remit the payments to the trust until the 25th of

the month. In the interim, servicers invest the funds they have collected from the mortgagors, and

they retain all investment income. Servicers can also obtain float income from escrow balances

collected monthly from borrowers to pay taxes and insurance during the course of the year.

Third, servicers are generally permitted to retain all ancillary fees they can collect from

mortgagors. This includes things like late fees and fees for balance checks or telephone

payments. It also includes fees for expenses involved in handling defaulted mortgages, such as

inspecting the property. Finally, servicers can hold securities themselves directly as investors,

and often hold the junior-most, residual tranche in the securitization.

Servicers face several costs. In addition to the operational expenses of sending out billing

statements, processing payments, maintaining account balances and histories, and restructuring

or liquidating defaulted loans, private label RMBS servicers face the expense of “servicing

advances.”29 When a loan defaults, the servicer is responsible for advancing the missed payments

of principal and interest to the trust as well as paying taxes and insurance on the property. They

continue to pay clear through liquidation of the property, unless these advances are not deemed

recoverable.

The servicer is able to recover advances it has made either from liquidation proceeds or

from collections on other loans in the pool, but the RMBS servicer does not receive interest on

its advances. Therefore, advances can be quite costly to servicers in terms of the time value of

money and can also place major strains on servicers’ liquidity, as the obligation to make

advances continues until the loan is liquidated or the servicer believes that it is unlikely to be

able to recover the advances. In some cases, servicers have to advance years’ worth of mortgage

payments to the trust.

While RMBS servicers do not receive interest on servicing advances, they are

compensated for their “out-of-pocket” expenses. This includes any expenses spent on preserving

the collateral property, including force-placed insurance, legal fees, and other foreclosure-related

expenses. Large servicers frequently “in-source” default management expenses to their affiliates.

***D. MONITORING OF RMBS SERVICERS***

RMBS servicing arrangements present a classic principal-agent problem wherein the

agent’s incentives are not aligned with the principal and the principal has limited ability to

monitor or discipline the agent.

*1. Investors*

Investors are poorly situated to monitor servicer behavior because they do not have direct

dealings with the servicer. RMBS investors lack information about servicer loss mitigation

activity. Investors do not have access to detailed servicer expense reports or the ability to

examine loss mitigation decisions.

29 In Agency securities, servicers generally stop advancing after borrowers owe their fifth payment, at 120 days past due. For GSE

loans, they are then removed from the securities and taken on balance sheet. Servicer advances for the four payments are typically not reimbursed

until termination.

Investors are able to see only the ultimate outcome. This means that investors are limited in their

ability to evaluate servicers’ performance on an ongoing basis. And even if investors were able

to detect unfaithful agents, they have little ability to discipline them short of litigation.

*2. Trustees*

RMBS feature a trustee, but the name is deceptive. The trustee is not a common law

trustee with general fiduciary duties. Instead, it is a limited purpose corporate trustee whose

duties depend on whether there has been a default as defined UN the PSA. A failure to pay all

tranches their regularly scheduled principal and interest payments is *not* an event of default.

Instead, default relates to the financial condition of the servicer, whether the servicer has made

required advances to the trust, whether the servicer has submitted its monthly report, and whether

the servicer has failed to meet any of its covenants under the PSA.

Generally, before there is an event of default, the trustee has a few specifically assigned

ministerial duties and no others.30 These duties are typically transmitting funds from the trust to

the RMBS investors and providing investors performance statements based on figures provided

by the servicer. The trustee’s pre-default duties do *not* include active monitoring of the servicer.

Trustees are generally entitled to rely on servicers’ data reporting, and have little

obligation to analyze it.31 Indeed, as Moody’s has noted, trustees lack the ability to verify most

data reported by servicers; at best they can ensure that the reported data complies with any

applicable covenant ratios:

The trustee is not in a position to verify certain of the numbers reported by the

servicer. For example, the amount of delinquent receivables and the amount of

receivables charged off in a given month are figures that are taken from the

servicer’s own computer systems. While these numbers could be verified by an

auditor, they are not verifiable by the trustee.32

Likewise, as attorney Susan Macaulay has observed, “In most cases, even if the servicer reports

are incorrect, or even fraudulent, absent manifest error, the trustee simply has no way of knowing

that there is a problem, and must allocate the funds into the appropriate accounts, and make the

mandated distributions, in accordance with the servicer reports.”33

30 *See, e.g.*, Wells Fargo Mortgage Backed Securities 2006-AR10 Trust § 8.01 (“Prior to the occurrence of an Event of Default of

which a Responsible Officer of the Trustee shall have actual knowledge and after the curing of all such Events of Default which may have

occurred, the duties and obligations of the Trustee shall be determined solely by the express provisions of this Agreement, the Trustee shall not be

liable except for the performance of such duties and obligations as are specifically set forth in this Agreement, no implied covenants or

obligations shall be read into this Agreement against the Trustee and, in the absence of bad faith on the part of the Trustee, the Trustee may

conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions

furnished to the Trustee, and conforming to the requirements of this Agreement.”). *See also* Moody’s Investor Service, Structured Finance

Ratings Methodology: Moody’s Re-examines Trustees’ Role in ABS and RMBS, Feb. 4, 2003, at 4. (noting “Some trustees have argued that

their responsibilities are limited to strictly administrative functions as detailed in the transaction documents and that they have no "fiduciary" duty

prior to an event of default.”).

31 MBIA Ins. Corp. v. Royal Indem. Co., 519 F. Supp. 2d 455 (2007), *aff’d* 321 Fed. Appx. 146 (3d Cir. 2009) (“Royal argues that

Wells Fargo [the trustee] had the contractual obligation to analyze data using certain financial accounting principles and to detect any anomalies

that analysis might have uncovered. As Royal suggests, this analysis may not have been very labor-intensive. Yet, the contract did not call for any

analysis at all. It simply required Wells Fargo to perform rote comparisons between that data and data contained in various other sources, and to

report any numerical inconsistencies. Wells Fargo did just that.”).

32 Moody’s Investor Service, *supra* note 30, at 4.

33 Susan J. Macaulay, *US: The Role of the Securitisation Trustee,* GLOBAL SECURITISATION AND STRUCTURED FINANCE 2004.

Macaulay further notes that:

Similarly, trustees usually wait for servicers to notify them of defaults,34 and Moody’s

has noted that trustees are often unresponsive to information from third parties indicating that an

unreported default might have occurred.35 Thus, trustees enforce servicer representations and

warranties largely on the honor system of servicer self-reporting.

For private-label securities, trustees also lack the incentive to engage in more vigorous

monitoring of servicer loss mitigation decisions. The trustee does not get paid more for more

vigorous monitoring. The trustee generally has little ability to discipline the servicer except for

litigation. Private-label RMBS trustees have almost no ability to fire or discipline a servicer.

Servicers can only be dismissed for specified acts, and these acts are typically limited to the

servicer’s insolvency or failure to remit funds to the trust. Occasionally servicers may be

dismissed if default levels exceed particular thresholds.

Trustees also have no interest in seeing a servicer dismissed because they often are

required to step in as back-up servicer.36 In the event of a servicer default, the trustee takes over

as servicer (which includes the option of subcontracting the duties), and assumes the duty of

making servicing advances to the trust. The back-up servicer role is essentially an insurance

policy for investors, and activation of that role is equivalent to payment on a claim; a trustee that

has to act as a back-up servicer is likely to lose money in the process, especially when some of

the trustees do not themselves own servicing operations.

Trustees also often have close relationships with particular servicers. For example,

Professor Tara Twomey and I have shown that Bank of America/Countrywide accounts for

nearly two-thirds of Deutsche Bank’s RMBS trustee business.37

In such circumstances, trustees are unlikely to engage in meaningful monitoring and disciplining

of servicers.38 Amherst Securities points out that early payment default provisions are not

effectively enforced by trustees, to the point where in cases where borrowers did not make a

single payment on the mortgage, only 37 percent were purchased out of the trust, much smaller

amounts for loans making only one to six payments.39 Thus, for private-label RMBS, there is

virtually no supervision of servicers.40

GSE and Ginnie Mae securitization have greater oversight of servicers. The GSEs serve as

master servicers on most of their RMBS; they therefore have a greater ability to monitor servicer

compliance. The GSEs require servicers to foreclose according to detailed timelines, and

servicers that fail to comply face monetary penalties.

It is almost always an event of default under the indenture if the trustee does not receive a servicer report within a specified period of

time, and the trustee must typically report such a failure to the investors, any credit enhancement provider, the rating agencies and others.

However, the trustee generally has no duties beyond that with respect to the contents of the report, although under the TIA, the trustee must

review any reports furnished to it to determine whether there is any violation of the terms of the indenture. Presumably this would include

verifying that any ratios represented in any reports conform to financial covenants contained in the indenture, etc. It would not however, require

the trustee to go beyond the face of the report, i.e. to conduct further investigation to determine whether the data underlying the information on

the reports presented to it were, in fact, true. Virtually all indentures, whether or not governed by the TIA, explicitly permit the trustee to rely on

statements made to the trustee in officers’ certificates, opinions of counsel and documents delivered to the trustee in the manner specified within

the indenture.

*Id.*

34 Moody’s Investor Service, *supra* note 30, at 4.

35 *Id.*

36 Eric Gross, *Portfolio Management: The Evolution of Backup Servicing*, Portfolio Financial Servicing Company (PFSC)

(July 11, 2002) *at* http://www.securitization.net/knowledge/article.asp?id=147&aid=2047.

37 Adam J. Levitin & Tara Twomey, *Mortgage* Servicing, 28 YALE J. ON REG. (forthcoming 2011).

38 *See* Ellington Credit Fund, Ltd. v. Select Portfolio, Inc., No. 1:07-cv-00421-LY, W.D. Tex., Plaintiffs’ First Amended Complaint,

July 10, 2007 (RMBS residual tranche holder alleging that trustee was aware that servicer was in violation of PSA and failed to act).

39 *See* Amherst Mortgage Insight, “The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations”, 15,

May 20, 2010.

40 For MBS with separate master and primary servicers, the master servicer may monitor the primary servicer(s), but often the master

and primary servicers are the same entity.

Recognizing the benefits inherent in effective loss mitigation, Fannie Mae places staff directly in

all of the largest servicer shops to work alongside loss mitigation staff at their servicers.41

Freddie Mac constructed servicer performance profiles to directly monitor servicers, sharing

results directly with servicers and rating agencies. Since each GSE insures against credit losses

on the loans, their ongoing monitoring provides consistent rules and a single point of contact to

approve workout packages and grant exceptions, something absent in private label RMBS.

*3. Ratings and Reputation*

Like any repeat transaction business, servicers are concerned about their reputations. But

reputational sanctions have only very weak discipline on servicer behavior.

While Regulation AB requires servicers to disclose information about their experience

and practices,42 they are not required to disclose information about performance of past pools

they have serviced. In any event, reputational sanctions are ineffective because loss severities are

more likely to be attributed to underwriting quality than to servicing decisions.

Rating agencies also produce servicer ratings, but these ratings are a compilation of the

evaluation of servicers on a multitude of characteristics. Rating agencies have been known to

incorporate features of Freddie Mac’s servicer performance profiles in their servicer assessments

and to incorporate loss mitigation performance into their ratings. But details of their

methodology used to measure these assessments are not disclosed. They give no indication of

whether a servicer is likely to make loss mitigation decisions based solely on the interests of the

securitization trust. Ratings are also combined with other criteria, such as the servicer’s own

financial strength and operational capacity. In other words, servicer ratings go to the question of

whether a servicer will have to be replaced because it is insolvent or lacks the ability to service

the loans, with much less weight given to whether the servicer acts in the investors’ interests.

***C. THE MORTGAGE CONTRACT AND FORECLOSURE PROCESS***

The mortgage contract consists of two documents, a promissory note (the “note” or the

“mortgage loan”) and a security instrument (the “mortgage” or the “deed of trust”).43 The note is

the IOU that contains the borrower’s promise to repay the money loaned. If the note is a

negotiable instrument, meaning that it complies with the requirements for negotiability in Article

3 of the Uniform Commercial Code,44 then the *original physical note* is itself the right to

payment.45

The mortgage is the document that connects the IOU with the house. The mortgage gives the

lender a contingent right to the house; it provides that *if* the borrower does not pay according to

the terms of the note, then the lender can foreclose and have the property sold *according to the*

*terms of the mortgage and applicable state and federal law*

41 PMI insurers have recently started to embed staff in servicer shops to monitor loss mitigation efforts. Harry Terris & Kate Berry, *In*

*the Trenches*, AM. BANKER, Aug. 27, 2009.

42 17 C.F.R. § 229.1108.

43 The note and the mortgage can be combined in a single document, but that is not common practice, both because the mortgage can

be granted subsequent to the creation of the debt and because of borrower privacy concerns about the terms of the note, which would become

public if the note and mortgage were combined and recorded in local property records.

44 *See* UCC 3-104.

45 UCC 3-203, Cmt. 1 (“An instrument is a reified right to payment. The right is represented by the instrument itself.”)

*.* The applicable law governing foreclosures is state law.46

State real estate law, including foreclosure law, is non-uniform, making it difficult to

state what the law is as a generic matter; there is always the possibility that some jurisdictions

may deviate from the majority rule. That said, no state requires a borrower’s note to be recorded

in local land records for the note to be valid, and, as a general matter, state law does not require

the mortgage to be recorded either in order for the mortgage to be enforceable against the

borrower. Recording of the mortgage is necessary, however, to establish the mortgage’s priority

relative to the claims of other parties, including other mortgagees, judgment lien creditors and

tax and workmen’s’ liens against the property. The basic rule of priority is first in time, first in

right; the first mortgage to be recorded has senior priority. An unrecorded mortgage will thus,

generally have junior priority to a subsequently issued, but recorded mortgage. The difference

between enforceability and priority is an important one, discussed in more detail below, in the

section of this testimony dealing with MERS.

State law on foreclosures is also non-uniform. Roughly, however, states can be divided

into two groups: those where foreclosure actions are conducted through the courts (“judicial

foreclosure”) and those where foreclosure actions are conducted by private sales (“nonjudicial

foreclosure”). This division maps, imperfectly, with whether the preferred security instrument is

a mortgage or a deed of trust.47

Mortgage loans cost more in states that have judicial foreclosure; what this means is that

borrowers in judicial foreclosure states are paying more for additional procedural rights and legal

protections; those procedural rights are part of the mortgage contract; failure to honor them is a

breach of the mortgage contract. Note, that a default on the mortgage note is not a breach of the

contract per se; instead it merely triggers the lender’s right to foreclose per the applicable

procedure.

In a typical judicial foreclosure proceeding, the homeowner receives a notice of default

and if that default is not cured within the required period, the mortgagee then files a foreclosure

action in court. The action is commenced by the filing of a written complaint that sets forth the

mortgagee’s allegations that the homeowner owes a debt that is secured by a mortgage and that

the homeowner has defaulted on the debt. Rules of civil procedure generally require that legal

actions based upon a writing include a copy of the writing as an attachment to the complaint,

although there is sometimes an exception for writings that are available in the public records.

While the mortgage is generally filed in the public records, assignments of the mortgage are

often not (an issue complicated by MERS, discussed below), and the note is almost never a

matter of public record.

It is important to understand that most judicial foreclosures do not function like the sort

of judicial proceeding that is dramatized on television, in which all parties to the case appear in

court, represented by attorneys and judgment only follows a lengthy trial. Instead, the norm in

foreclosure cases is a default judgment. Most borrowers do not appear in court or contest their

foreclosures, and not all of those who do are represented by competent counsel, not least because

of the difficulties in paying for counsel.

46 There is a federal foreclosure statute that can be utilized by the federal government. *See* 12 U.S.C. §§ 3701-3713 (multi-family

property foreclosures); §§3751-3768 (single-family property foreclosures).

47 Mortgages sometimes also include a power of sale, permitting nonjudicial foreclosure. In a deed of trust, the deed to the property is

transferred in trust for the noteholder to a deed of trust trustee, often a local attorney. The note remains the property of the lender (the deed of

trust beneficiary). When there is a default on the note, the lender notifies the deed of trust trustee and the lender or its agent is typically appointed

as substitute deed of trust trustee to run the foreclosure sale.

Most borrowers that the borrower does not contest the foreclosure or appear in court. In most

cases, only the lender’s attorney appears, and judges routinely dispatch dozens or hundreds of

foreclosure cases in a sitting. Homeowners in foreclosure actions are among the most vulnerable

of defendants, the least able to insist up on

and vindicate their rights, and accordingly the ones most susceptible to abuse of legal process.

**II. PROCEDURAL PROBLEMS AND FRAUD**

The first type of problems in the mortgage market are what might generously be termed

“procedural defects” or “procedural irregularities.” There are numerous such problems that have

come to light in foreclosure cases. The extent and distribution of these irregularities is not yet

known. No one has compiled a complete typology of procedural defects in foreclosures; there

are, to use Donald Rumsfeld’s phrase, certainly “known unknowns” and well as “unknown

unknowns.”

***A. AFFIDAVITS FILED WITHOUT PERSONAL KNOWLEDGE (ROBOSIGNING)***

Affidavits need to be based on personal knowledge to have any evidentiary effect; absent

personal knowledge an affidavit is hearsay and therefore generally inadmissible as evidence.

Accordingly, affidavits attest to personal knowledge of the facts alleged therein.

The most common type of affidavit is an attestation about the existence and status of the loan,

namely that the homeowner owes a debt, how much is currently owed, and that the homeowner

has defaulted on the loan. (Other types of affidavits are discussed in sections II.B. and II.C.,

*infra*). Such an affidavit is typically sworn out by an employee of a servicer (or sometimes by a

law firm working for a servicer). Personal knowledge for such an affidavit would involve, at the

very least, examining the payment history for a loan in the servicer’s computer system and

checking it against the facts alleged in a complaint.

The problem with affidavits filed in many foreclosure cases is that the affiant lacks any

personal knowledge of the facts alleged whatsoever. Many servicers, including Bank of

America, Citibank, JPMorgan Chase, Wells Fargo, and GMAC, employ professional affiants,

some of whom appear to have no other duties than to sign affidavits. These employees cannot

possibly have personal knowledge of the facts in their affidavits. One GMAC employee, Jeffrey

Stephan, stated in a deposition that he signed perhaps 10,000 affidavits in a month, or

approximately 1 a minute for a 40-hour work week.48 For a servicer’s employee to ascertain

payment histories in a high volume of individual cases is simply impossible.

When a servicer files an affidavit that claims to be based on personal knowledge, but is

not in fact based on personal knowledge, the servicer is committing a fraud on the court, and

quite possibly perjury. The existence of foreclosures based on fraudulent pleadings raises the

question of the validity of foreclosure judgments and therefore title on properties, particularly if

they are still in real estate owned (REO).

48 *See* Deposition of Jeffrey Stephan, GMAC Mortgage LLC v. Ann M. Neu a/k/a Ann Michelle Perez, No. 50 2008 CA

040805XXXX MB, (15th Judicial Circuit, Florida, Dec. 10, 2009) at 7, *available at*

http://api.ning.com/files/s4SMwlZXvPu4A7kq7XQUsGW9xEcYtqNMPCm0a2hISJu88PoY6ZNqanX7XK41Fyf9gV8JIHDme7KcFO2cvHqSE

McplJ8vwnDT/091210gmacmortgagevsannmneu1.pdf (stating that Jeffrey Stephan, a GMAC employee, signed approximately 10,000 affidavits

a month for foreclosure cases).

***B. LOST NOTE AFFIDAVITS FOR NOTES THAT ARE NOT LOST***

The plaintiff in a foreclosure action is generally required to produce the note as evidence that it

has standing to foreclose. Moreover, under the Uniform Commercial Code, if the note is a

negotiable instrument, only a holder of the note (or a subrogee)—that is a party in possession of

the note— may enforce the note, as the note is the reified right to payment.49

There is an exception, however, for lost, destroyed, or stolen notes, which permits a party that

has lost possession of a note to enforce it.50 If a plaintiff seeks to enforce a lost note, it is

necessary “to prove the terms of the instrument” as well as the “right to enforce the

instrument.”51 This proof is typically offered in the form of a lost note affidavit that attests to the

prior existence of the note, the terms of the note, and that the note has been lost.

It appears that a surprisingly large number of lost note affidavits are filed in foreclosure

cases. In Broward County, Florida alone, over 2000 such affidavits were filed in 2008-2009.52

Relative to the national population, that translates to roughly 116,000 lost note affidavits

nationally over the same period.53

There are two problems with the filing of many lost note affidavits. First, is a lack of

personal knowledge. Mortgage servicers are rarely in possession of the original note. Instead, the

original note is maintained in the fireproof vault of the securitization trustee’s document

custodian. This means that the servicer lacks personal knowledge about whether a note has or has

not been lost.54 Merely reporting a communication from the document custodian would be

hearsay and likely inadmissible as evidence.

The second problem is that the original note is frequently not in fact lost. Instead, it is in

the document custodian’s vault. Servicers do not want to pay the document custodian a fee (of

perhaps $30) to release the original mortgage, and servicers are also wary of entrusting the

original note to the law firms they hire. Substitution of counsel is not infrequent on defaulted

mortgages, and servicers are worried that the original note will get lost in the paperwork shuffle

if there is a change in counsel. When pressed, however, servicers will often produce the original

note, months after filing lost note affidavits. The Uniform Commercial Code (UCC) requires that

a party seeking to enforce a note be a holder (or subrogee to a holder) or produce evidence

that a note has been lost, destroyed, or stolen; the UCC never contemplates an “inconvenience

affidavit” that states that it is too much trouble for a servicer to bother obtaining the original

note. But that is precisely what many lost note affidavits are effectively claiming.

Thus, many lost note affidavits are doubly defective: they are sworn out by a party that

does not and cannot have personal knowledge of the alleged facts and the facts being alleged are

often false as the note is not in fact lost, but the servicer simply does not want to bother obtaining

it.

49 UCC 3-301; 1-201(b)(21) (defining “holder”).

50 UCC 3-309. Note that UCC 3-309 was amended in the 2001 revision of Article 3. The revision made it easier to enforce a lost

note. Not every state has adopted the 2001 revisions. Therefore, UCC 3-309 is non-uniform law.

51 UCC 3-309(b).

52 Gretchen Morgenson & Andrew Martin, *Battle Lines Forming in Clash Over Foreclosures*, N.Y. TIMES, Oct. 20, 2010, at A1.

53 According to the US Census Bureau, Broward County’s population is approximately 1.76 million, making it .57% of the total US

population of 307 million. Broward does have a significantly higher than average foreclosure rate, roughly 12% over the past two years,

according to Core Logic Loan Performance data, making it approximately 3 times the national average.

54 The 2001 version of UCC 3-309 permits not only a party that has lost a note but a buyer from such a party to enforce a lost note.

***C. JUNK FEES***

The costs of foreclosure actions are initially incurred by servicers, but servicers recover

these fees off the top from foreclosure sale proceeds before MBS investors are paid. This

reimbursement structure limits servicers’ incentive to rein in costs and actually incentives them

to pad the costs of foreclosure. This is done in two ways. First, servicers charge so-called “junk

fees” either for unnecessary work or for work that was simply never done. Thus, Professor Kurt

Eggert has noted a variety of abusive servicing practices, including “improper foreclosures or

attempted foreclosures; imposition of improper fees, especially late fees; forced-placed insurance

that is not required or called for; and misuse of escrow funds.”55

Servicers’ ability to retain

foreclosure-related fees has even led them to attempt to foreclose on properties when the

homeowners are current on the mortgage or without attempting any sort of repayment plan.56

Consistently, Professor Katherine Porter has documented that when mortgage creditors file

claims in bankruptcy, they generally list amounts owed that are much higher than those

scheduled by debtors.57

There is also growing evidence of servicers requesting payment for services not

performed or for which there was no contractual right to payment. For example, in one

particularly egregious case from 2008, Wells Fargo filed a claim in the borrower’s bankruptcy

case that included the costs of two brokers’ price opinions allegedly obtained in September 2005,

on a property in Jefferson Parish, Louisiana when the entire Parish was under an evacuation

order due to Hurricane Katrina.58

Similarly, there is a frequent problem of so-called “sewer summons” issued (or actually

not issued) to homeowners in foreclosures. Among the costs of foreclosure actions is serving

notice of the foreclosure (a court summons) on the homeowner. There is disturbing evidence that

homeowners are being charged for summons that were never issued. These non-delivered

summons are known as “sewer summons” after their actual delivery destination.

One way in which these non-existent summons are documented is through the filing of

“affidavits of lost summons” by process servers working for the foreclosure attorneys hired by

mortgage servicers. A recent article reports that in Duval County, Florida (Jacksonville) the

number of affidavits of lost summons has ballooned from 1,031 from 2000-2006 to over 4,000 in

the last two years, a suspiciously large increase that corresponds with a sharp uptick in

foreclosures.**59**

Because of concerns about illegal fees, the United States Trustee’s Office has undertaken several

investigations of servicers’ false claims in bankruptcy60

and brought suit against Countrywide,61

while the Texas Attorney General has sued American Home Mortgage Servicing for illegal debt

collection practices.62

55 Kurt Eggert, *Comment on Michael A. Stegman et al.’s “Preventive Servicing Is Good for Business and Affordable Homeownership*

*Policy”: What Prevents Loan Modifications?*, 18 HOUSING POL’Y DEBATE 279 (2007).

56 Eggert, *Limiting Abuse*, *supra* note 21, at 757.

57 Katherine M. Porter, *Mortgage Misbehavior*, 87 TEX. L. REV. 121, 162 (2008).

58 *In re* Stewart, 391 B.R. 327, 355 (Bankr. E.D. La. 2008).

59 Matt Taibi, *Courts Helping Banks Screw Over Homeowners,* ROLLING STONE, Nov. 25, 2010, *at*

http://www.rollingstone.com/politics/news/17390/232611?RS\_show\_page=7.

60 Ashby Jones, *U.S. Trustee Program Playing Tough With Countrywide, Others*, LAW BLOG (Dec. 3, 2007, 10:01 AM), *at*

http://blogs.wsj.com/law/2007/12/03/us-trustee-program-playing-tough-with-countrywide-others.

The other way in which servicers pad the costs of foreclosure is by in-sourcing their

expenses to affiliates at above-market rates. For example, Countrywide, the largest RMBS

servicer, force places insurance on defaulted properties with its captive insurance affiliate

Balboa.63 Countrywide has been accused of deliberately extending the time to foreclosure in

order to increase the insurance premiums paid to its affiliate, all of which are reimbursable by the

trust, before the RMBS investors’ claims are paid.64 Similarly, Countrywide in-sources trustee

services in deed of trust foreclosures to its subsidiary Recon Trust.65

Thus, in Countrywide’s’ 2007 third quarter earnings call, Countrywide’s President David

Sambol emphasized that increased revenue from in-sourced default management functions could

offset losses from mortgage defaults.

Now, we are frequently asked what the impact on our servicing costs and earnings

will be from increased delinquencies and loss mitigation efforts, and what

happens to costs. And what we point out is, as I will now, is that *increased*

*operating expenses in times like this tend to be fully offset by increases in*

*ancillary income in our servicing operation, greater fee income from items like*

*late charges, and importantly from in-sourced vendor functions* that represent part

of our diversification strategy, a counter-cyclical diversification strategy such as

our businesses involved in foreclosure trustee and default title services and

property inspection services.66

In June, 2010, Countrywide settled with the FTC for $108 million on charges that it overcharged

delinquent homeowners for default management services. According to the FTC, Countrywide

ordered property inspections, lawn mowing, and other services

meant to protect the lender’s interest in the property… But rather than simply hire

third-party vendors to perform the services, Countrywide created subsidiaries to

hire the vendors. The subsidiaries marked up the price of the services charged by

the vendors – often by 100% or more – and Countrywide then charged the

homeowners the marked-up fees.67

Among the accusations brought against Countrywide in a recent investor notice of default filed

by the Federal Reserve Bank of New York along with BlackRock and PIMCO, is that

Countrywide has been padding expenses via in-sourcing on the 115 trusts covered by the letter.68

61 Complaint, Walton v. Countrywide Home Loans, Inc. (*In re* Atchely), No. 05-79232 (Bankr. N.D. Ga. filed Feb. 28, 2008).

62 Complaint, State v. Am. Home Mtg. Servicing, Inc., No. 2010-3307 (Tex. Dist. Ct. 448th Jud. Dist. filed Aug. 30, 2010).

63 Amherst Mortgage Insight, 2010, “The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations,” 23,

May 20, 2010.

64 *Id.*

65 Center for Responsible Lending, *Unfair and Unsafe: How Countrywide’s irresponsible practices have harmed borrowers and*

*shareholders*, CRL Issue Paper, Feb. 7, 2008, at 6-7.

66 Transcript, “Countrywide Financial Corporation Q3 2007 Earnings Call,” Oct. 26, 2007 (emphasis added) (also mentioning “Our

vertical diversification businesses, some of which I mentioned, are counter-cyclical to credit cycles, like the lender-placed property business in

Balboa and like the in-source vendor businesses in our loan administration unit.”).

67 FTC, Press Release, June 7, 2010, *Countrywide Will Pay $108 Million for Overcharging Struggling Homeowners; Loan Servicer*

*Inflated Fees, Mishandled Loans of Borrowers in Bankruptcy*.

68 Kathy D. Patrick, Letter to Countrywide Home Loan Servicing LP and the Bank of New York, dated Oct. 18, 2010, *available at*

http://www.scribd.com/Bondholders-Letter-to-BofA-Over-Countrywide-Loans-inc-NY-Fed/d/39686107.

Countrywide is hardly the only servicer accused of acting in its interests at the expense of

investors. Carrington, another major servicer, also owns the residual tranche on many of the

deals it services. Amherst Mortgage Securities has shown that Carrington has been much slower

than other servicers to liquidate defaulted loans.69 Delay benefits Carrington both as a servicer

and as the residual tranche investor. As a servicer, delay helps Carrington by increasing the

number of monthly late fees that it can levy on the loans. These late fees are paid from

liquidation proceeds before any of the MBS investors.

As an investor in the residual tranche, Carrington has also been accused of engaging in

excessive modifications to both capture late fees and to keep up the excess spread in the deals, as

it is paid directly to the residual holders.70 When loans were mass modified, Carrington benefited

as the servicer by capitalizing late fees and advances into the principal balance of the modified

loans, which increased the balance on which the servicing fee was calculated.

Carrington also benefited as the residual holder by keeping up excess spread in the deals and

delaying delinquency deal triggers that restrict payments to residual holders when delinquencies

exceed specified levels. Assuming that the residual tranche would be out of the money upon a

timely foreclosure, delay means that Carrington, as the residual holder, receives many more

months of additional payments on the MBS it holds than it otherwise would.71

It is important to emphasize that junk fees on homeowners ultimately come out of the

pocket of MBS investors. If the homeowner lacks sufficient equity in the property to cover the

amount owed on the loan, including junk fees, then there is a deficiency from the foreclosure

sale. As many mortgages are legally or functionally non-recourse, this means that the deficiency

cannot be collected from the homeowner’s other assets. Mortgage servicers recover their

expenses off the top in foreclosure sales, before MBS investors are paid. Therefore, when a

servicer lards on illegal fees in a foreclosure, it is stealing from investors such as pension plans

and the US government.

***D. COMPLAINTS THAT FAIL TO INCLUDE THE NOTE***

Rule of civil procedure generally require that a compliant based on a writing include, as

an attachment, a copy of a writing. In a foreclosure action, this means that both the note and the

mortgage and any assignments of either must be attached. Beyond the rules of civil procedure

requirement, these documents are also necessary as an evidentiary matter to establish that the

plaintiff has standing to bring the foreclosure. Some states have exceptions for public records,

which may be incorporated by reference, but it is not always clear whether this exception applies

in foreclosure actions. If it does, then only the note, which is not a public record, would need to

be attached.

69 Amherst Mortgage Insight, 2010, “The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations”, pp.

22-24, May 20, 2010.

70 See Amherst Mortgage Insight, “Why Investors Should Oppose Servicer Safe Harbors”, April 28, 2009. Excess spread is the

difference between the income of the SPV in a given period and its payment obligations on the MBS in that period, essentially the SPV’s periodic

profit. Excess spread is accumulated to supplement future shortfalls in the SPV’s cashflow, but is either periodically released to the residual

tranche holder. Generally, as a further protection for senior MBS holders, excess spread cannot be released if certain triggers occur, like a decline

in the amount of excess spread trapped in a period beneath a particular threshold.

71 Carrington would still have to make servicing advances on any delinquent loans if it stretched out the time before foreclosure, but

these advances would be reimbursable, and the reimbursement would come from senior MBS holders, rather than from Carrington, if it were out

of the money in the residual.

Many foreclosure complaints are facially defective and should be dismissed because they fail to

attach the note. I have recently examined a small sample of foreclosure cases filed in Allegheny

County, Pennsylvania (Pittsburgh and environs) in May 2010. In over 60% of those foreclosure

filings, the complaint failed to include a copy of the note. Failure to attach the note appears to be

routine practice for some of the foreclosure mill law firms, including two that handle all of Bank

of America’s foreclosures.

I would urge the Committee to ask Bank of America whether this was an issue it

examined in its internal review of its foreclosure practices.

***E. COUNTERFEIT AND ALTERED DOCUMENTS AND NOTARY FRAUD***

Perhaps the most disturbing problem that has appeared in foreclosure cases is evidence of

counterfeit or altered documents and false notarizations. To give some examples, there are cases

in which multiple copies of the “true original note” are filed in the same case, with variations in

the “true original note;”72 signatures on note allonges that have clearly been affixed to documents

via Photoshop;73 “blue ink” notarizations that appear in blank ink; counterfeit notary seals;74

backdated notarizations of documents issued before the notary had his or her commission;75 and

assignments that include the words “bogus assignee for intervening asmts, whose address is

XXXXXXXXXXXXXXXXX.”76

Most worrisome is evidence that these frauds might not be one-off problems, but an

integral part of the foreclosure business. A price sheet from a company called DocEx that was

affiliated with LPS, one of the largest servicer support firms, lists prices for various services

including the “creation” of notes and mortgages. While I cannot confirm the authenticity of this

price sheet or date it, it suggests that document counterfeiting is hardly exceptional in foreclosure

cases.

While the fraud in these cases is not always by servicers themselves, but sometimes by

servicer support firms or attorneys, its existence should raise serious concerns about the integrity

of the foreclosure process. I would urge the Committee to ask the servicer witnesses what steps

they have taken to ascertain that they do not have such problems with loans in their servicing

portfolios.

***G. THE EXTENT OF THE PROBLEM***

The critical question for gauging the risk presented by procedural defects is the extent of the

defects. While Federal Reserve Chairman Bernanke has announced that federal bank regulators

are looking into the issue and will issue a report this month, I do not believe that it is within the

ability of federal bank regulators to gauge the extent of procedural defects in foreclosure cases.

Brief of Antonio Ibanez, Defendant-Appellee, US Bank Nat’l Assn, as Trustee for the Structured Asset Securities Corporation

Mortgage Pass-Through Certificates, Series 2006-Z v. Ibanez; Wells Fargo Bank, N.A. as Trustee for ABFC 2005-Opt 1 Trust, ABFC Asset

Backed Certificates Series 2005-OPT 1, No 10694, (Mass. Sept. 20, 2010), at 10 (detailing 3 different “certified true copies” of a note allonge

and of an assignment of a mortgage); http://4closurefraud.org/2010/04/27/foreclosure-fraud-of-the-week-two-original-wet-ink-notes-submittedinthe-

same-case-by-the-florida-default-law-group-and-jpmorgan-chase/ (detailing a foreclosure file with two different “original” wet ink notes

for the same loan).

73 http://4closurefraud.org/2010/04/08/foreclosure-fraud-of-the-week-poor-photoshop-skills/.

74 *See* WSTB.com, *at* http://www.wsbtv.com/video/25764145/index.html.

75 Deposition of Cheryl Samons, Deutsche Bank Nat’l Trust Co., as Trustee for Morgan Stanley ABS Capital 1 Inc. Trust 2006-HE4 v.

Pierre, No. 50-2008-CA-028558-XXXX-MB (15th Judicial Circuit, Florida, May 20, 2009, *available at*

http://mattweidnerlaw.com/blog/wpcontent/

uploads/2010/03/depositionsammons.pdf.

76 http://www.nassauclerk.com/clerk/publicrecords/oncoreweb/showdetails.aspx?id=809395&rn=0&pi=0&ref=search.

To do so would require, at the very least, an extensive sampling of actual

foreclosure filings and their examination by appropriately trained personnel. I am unaware of

federal bank regulators undertaking an examination of actual foreclosure filings, much less

having a sufficient cadre of appropriately trained personnel. Bank examiners lack the experience

or training to evaluate legal documents like foreclosure filings. Therefore, any statement put

forth by federal regulators on the scope of procedural defects is at best a guess and at worse a

parroting of the “nothing to see here folks” line that has come from mortgage servicers.

I would urge the Committee to inquire with federal regulators as to exactly what steps

they are taking to examine foreclosure irregularities and how they can be sure that those steps

will uncover the extent of the problem. Similarly, I would urge the Committee to ask the

servicer witnesses what specific irregularities they examined during their self-imposed moratoria

and by what process. It defies credulity that a thorough investigation of all the potential problems

in foreclosure paperwork could be completed in a month or two, much less by servicers that have

taken so long to do a small number of loan modifications.

**III. CHAIN OF TITLE PROBLEMS**

A second problem and potentially more serious problem relating to standing to foreclose

is the issue of chain of title in mortgage securitizations.77 As explained above, securitization

involves a series of transfers of both the note and the mortgage from originator to sponsor to

depositor to trust. This particular chain of transfers is necessary to ensure that the loans are

“bankruptcy remote” once they have been placed in the trust, meaning that if any of the upstream

transferors were to file for bankruptcy, the bankruptcy estate could not lay claim to the loans in

the trust by arguing that the transaction was not a true sale, but actually a secured loan.78

Bankruptcy remoteness is an essential component of private-label mortgage securitization deals,

as investors want to assume the credit risk solely of the mortgages, not of the mortgages’

originators or securitization sponsors. Absent bankruptcy remoteness, the economics of mortgage

securitization do not work in most cases.

Recently, arguments have been raised in foreclosure litigation about whether the notes

and mortgages were in fact properly transferred to the securitization trusts. This is a critical issue

because the trust has standing to foreclose if, and only if it is the mortgagee. If the notes and

mortgages were not transferred to the trust, then the trust lacks standing to foreclose. There are

several different theories about the defects in the transfer process; I do not attempt to do justice

to any of them in this testimony.

77 Chain of title problems appear to be primarily a problem for private-label securitization, not for agency securitization because even

if title were not properly transferred for Agency securities, it would have little consequence. Investors would not have incurred a loss as the result

of an ineffective transfer, as their MBS are guaranteed by the GSEs or Ginnie Mae, and when a loan in an Agency pool defaults, it is removed

from the pool and the owned by the GSE or Ginnie Mae, which is then has standing to foreclose.

78 Bankruptcy remote has a second meaning, namely that the trust cannot or will not file of bankruptcy. This testimony uses

bankruptcy remote solely in the sense of whether the trust’s assets could be clawed back into a bankruptcy estate via an equity of redemption. The

Uniform Commercial Code permits a debtor to redeem collateral at face value of the debt owed. If a pool of loans bore a now-above-market

interest rate, the pool’s value could be above the face value of the debt owed, making redemption economically attractive.

It can be very difficult to distinguish true sales from secured loans. For example, a sale and repurchase agreement (a repo) is

economically identical to a secured loan from the repo buyer to the repo seller, secured by the assets being sold.

While the chain of title issue has arisen first in foreclosure defense cases, it also has

profound implications for MBS investors. If the notes and mortgages were not properly

transferred to the trusts, then the mortgage-backed securities that the investors’ purchased were

in fact *non-mortgage-backed securities*. In such a case, investors would have a claim for the

rescission of the MBS,79 meaning that the securitization would be unwound, with investors

receiving back their original payments at par (possibly with interest at the judgment rate).

Rescission would mean that the securitization sponsor would have the notes and mortgages on its

books, meaning that the losses on the loans would be the securitization sponsor’s, not the MBS

investors, and that the securitization sponsor would have to have risk-weighted capital for the

mortgages. If this problem exists on a wide-scale, there is not the capital in the financial system

to pay for the rescission claims; the rescission claims would be in the trillions of dollars, making

the major banking institutions in the United States would be insolvent.

The key questions for evaluating chain of title are what method of transferring notes and

mortgages is actually supposed to be used in securitization and whether that method is legally

sufficient both as a generic matter and as applied in securitization deals. There is a surprising

lack of consensus on both counts. Scholars and attorneys cannot agree either on what methods

would work generically, much less determine which were used in securitization transactions.

This means there is a great deal of legal uncertainty over these issues. Even among banks’

attorneys, different arguments appear in different litigation. For example, one possible method of

transfer—a sale under Article 9 of the Uniform Commercial Code—has never, to my knowledge,

been made by banks’ attorneys in foreclosure litigation when chain of title has been questioned,

even though it is one of the two methods that a recent American Securitization Forum (ASF)

white paper argues is proper.80 Even among the banks’ lawyers, then, there is lack of consensus

on what law governs transfers.

The following section outlines the potential methods of transfer and some of the issues

that arise regarding specific methods. It is critical to emphasize that the law is not settled on most

of the issues regarding securitization transfers; instead, these issues are just starting to be

litigated.

***A. TRANSFERS OF NOTES GENERALLY***

As a generic matter, a note can be transferred in one of four methods:

(1) The note can be sold via a contract of sale, which would be governed by the common law of

contracts.

(2) If the note is a negotiable instrument,81 it could be negotiated, meaning that it would be

transferred via endorsement and delivery, with the process governed by Article 3 of the

Uniform Commercial Code (UCC).82 The endorsement can either be a specific

79 This claim would not be a putback claim necessarily, but could be brought as a general contract claim. It could not be brought as a

securities law claim under section 11 of the Securities Act of 1933 because the statute of limitations for rescission has expired on all PLS.

80 American Securitization Forum, *Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market*, ASF

White Paper Series, Nov. 16, 2010, *at* http://www.americansecuritization.com/uploadedFiles/ASF\_White\_Paper\_11\_16\_10.pdf. The ASF white

paper notes that it has been reviewed and approved by 13 major (but unnamed) law firms. The ASF white paper does not report whether any of

these firms have outstanding opinion letter liability on securitization transactions.

81 It is not clear whether mortgage notes are necessarily negotiable instruments.

82 The note endorsement process works just like endorsements on checks and is governed by the same law.

endorsement to a named endorsee or an endorsement in blank that converts the note into bearer

paper.

(3) The note could be converted into an electronic note and transferred according to the

provisions of the federal E-SIGN Act.83

(4) The note could be sold pursuant to UCC Article 9, if it was sold after 2001.84 In 49 states

(South Carolina being the exception), Article 9 provides a method for selling a

promissory note, which requires that there be an authenticated (signed) agreement, value given,

and that the seller have rights in the property being transferred.85 This process is very similar to a

common law sale.

***B. TRANSFERS OF MORTGAGES GENERALLY***

There is general agreement that as a generic method, any of these methods of transfer

would work to effectuate a transfer of the note. No method is mandatory. Whether or not the

chosen process was observed in practice, is another matter, however.86 Concerns about

noncompliance is discussed below.

There are also several conceivable ways to transfer mortgages, but there are serious

doubts about the validity of some of the methods:

(1) The mortgage could be assigned through the traditional common law process, which

would require a document of assignment. There is general consensus that this process

works.

(2) The mortgage could be negotiated. This method of transfer is of questionable

effectiveness. A mortgage is not a negotiable instrument, and concepts of negotiability

do not fit well with mortgages. For example, if a mortgage were negotiated in blank, it

should become a “bearer mortgage,” but this concept is utterly foreign to the law, not

least as the thief of a bearer mortgage would have the ability to enforce the mortgage

(absent equitable considerations). Similarly, with a bearer mortgage, a homeowner could never

figure out who would be required to grant a release of the mortgage upon payoff.

And, in many states (so-called title theory states), a mortgage is considered actual

ownership of real property, and real property must have a definite owner (not least for

taxation purposes).

(3) The mortgage could “follow the note” per common law. While there is a good deal of

case law using this mellifluous phrase, common law is not wholly settled on the principle,

83 15 U.S.C. § 7021. E-SIGN imposes a number of requirements on electronic note transfers and also requires consent of the issuer

(maker) of the note.

84 The revisions of UCC Articles 1 and 9 went into effect nationally in 2001.

85 UCC 9-203. The language of Article 9 is abstruse, but UCC Revised Article 1 defines "security interest" to include the interest of a

buyer of a promissory note. UCC 1-201(b)(35). Article 9's definition of "debtor" includes a seller of a promissory note, UCC 9-102(a)(28)(B ),

and "secured party" includes a buyer of a promissory note, UCC 9-102(a)(72)(D). Therefore UCC 9-203, which would initially appear to address

the attachment (enforceability) of a security interest also covers the sale of a promissory note. South Carolina has not adopted the revised Article

1 definition of security interest necessary to make Article 9 apply to sales of promissory notes.

86 Note that common law sales and Article 9 sales do not affect the enforceability of the note against the obligor on the note. UCC 9-

308, Cmt.6, Ex. 3 (“Under this Article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect

the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person to whom the maker must

pay to discharge the note and any lien security it.”). UCC Article 3 negotiation and E-SIGN do affect enforceability as they enable a buyer for

value in good faith to be a holder in due course and thereby cut off some of the obligor’s defenses that could be raised against the seller. UCC 3-

305, 3-306; 15 U.S.C. § 7021(d).

and its meaning is not entirely clear (e.g., does it mean that a transfer of the note

effectuates a transfer of the mortgage or that the mortgage and the note cannot be

separated and both must be transferred—by their own processes— in order for either

transfer to work). There are also several instances where the mortgage clearly does not

follow the note. For example, the basic concept of a deed of trust is that the security

instrument and the note are separated; the deed of trust trustee holds the security, while

the beneficiary holds the note. Likewise, the mortgage follows the note concept would

imply that the theft of a note also constitutes theft of a mortgage, thereby giving to a thief more

than the thief was able to actually steal. Another situation would be where a

mortgage is given to a guarantor of a debt. The mortgage would not follow the debt, but

would (at best) follow the guarantee. And finally, the use of MERS, a recording utility,

as original mortgage (a/k/a MOM) splits the note and the mortgage. MERS has no claim

to the note, but MERS is the mortgagee. If taken seriously, MOM means that the

mortgage does not follow the note. While MERS might claim that MOM just means that

the beneficial interest in the mortgage follows the note, a transfer of the legal title would

violate a bankruptcy stay and would constitute a voidable preference if done before

bankruptcy.

(4) the mortgage could “follow the note” if it is an Article 9 transfer.87 There is consensus

that this process would work *if* Article 9 governs the transfer of the note.

***C. TRANSFERS IN RESIDENTIAL MORTGAGE SECURITIZATION TRANSACTIONS***

All the methods described above for transferring notes and mortgages are simply generic

methods. There may be additional requirements for a valid transfer, either as a function of trust

law or as agreed upon by the parties themselves by contract. Notably, the American

Securitization Forum’s white paper considers neither of these possibilities.88

*1. Trust Law*

Trust law creates additional requirements for transfers. RMBS typically involve a

transfer of the assets to a New York common law trust. Transfers to New York common law

trusts are governed by the common law of gifts. In New York, such a transfer requires actual

delivery of the transferred assets in a manner such that no one else could possibly claim

ownership.89 This is done to avoid fraudulent transfer concerns. For a transfer to a New York

common law trust, the mere recital of a transfer, is insufficient to effectuate a transfer;90 there

must be delivery in as perfect a manner as possible.91 Similarly, an endorsement in blank might

not be sufficient to effectuate a transfer *to a trust* because endorsement in blank turns a note into

bearer paper to which others could easily lay claim.

87 UCC 9-203(g). If the transfer is not an Article 9 transfer, then the Article 9 provision providing that the mortgage follows the note

would not apply.

88 *See supra*, note 80.

89 *See* Vincent v. Putnam, 248 N.Y. 76, 83 (N.Y. 1928) (“The delivery must be such as to vest the donee with the control and

dominion over the property and to absolutely divest the donor of his dominion and control, and the delivery must be made with the intent to vest

the title of the property in the donee….Equity will not help out an incomplete delivery.”).

90 *Id.* at 84 (“Mere words never constitute a delivery.”).

91 *In re* Van Alstyne, 207 N.Y. 298, 309 (N.Y. 1913).

*2. Private Contract*

The UCC is simply a set of default rules.92 Parties are free to contract around it, and need not do

so explicitly.93 Parties can thus impose by contract additional requirements for transfers to those

in Articles 3 and 9 or, alternatively, ease the requirements. PSAs appear to be precisely this type

of variation by agreement from the UCC. If so, then they would govern the transfers as a simple

matter of contract law. Deviation from the PSA requirements would be allowed, but only by the

extent permitted by contract law, and even if there were a deviation that constituted a material

breach of the contract, it would not void the transfer on a self-executing basis.

*3. Private Contract + Trust Law*

Trust law and private contract law combine to make a much more rigid set of transfer

requirements that contract law would by itself. New York law provides that a trustee’s authority

is limited to that provided in the trust documents.94 New York law also provides that any transfer

in contravention of the trust documents is void.95 Therefore, if the PSA—the trust document—

says that the transfer must be done in a certain way and the transfer did not comply, the transfer

is void, irrespective of whether it would comply with the Uniform Commercial Code or other

law. The trust document creates a higher level of conduct to which the transfer must comply.

PSAs require a specific form of transfer. First, the PSA contains a recital of the

transfer.96 But per New York trust law, that recital alone is insufficient to effectuate a transfer to

a common law trust.97 Second, PSAs contain a provision that calls for delivery to the trustee for

every mortgage loan in the deal of the original Mortgage Note bearing all intervening

endorsements showing a complete chain of endorsement from the originator to the last endorsee,

endorsed *“Pay to the order of \_\_\_\_\_\_\_\_\_\_\_\_\_, without recourse”* and signed (which may be by

facsimile signature) in the name of the last endorsee by an authorized officer.98

The reason for requiring this complete chain of endorsement from originator up through

the Depositor before a final endorsement to the trust is to provide a clear evidentiary basis for all

of the transfers in the chain of title in order to remove any doubts about the bankruptcy

remoteness of the assets transferred to the trust. Absent a complete chain of endorsements, it

could be argued that the trust assets were transferred directly from the originator to the trust,

raising the concern that if the originator filed for bankruptcy, the trust assets could be pulled

back into the originator’s bankruptcy estate

92 A few provisions of the UCC are mandatory, but these do not affect the chain of title issue.

93 UCC 1-203; 1-201(b)(3) (defining “agreement”).

94 14-140 Warren's Weed New York Real Property § 140.58 (“It is a fundamental principle of trust law that the instrument under

which the trustee acts is the charter of his rights. Therefore, in administering the trust, he must act in accordance with its terms. This rule applies

to every kind of trustee, regardless of whether the trustee is to hold, invest or pay over income, or to sell or liquidate for the benefit of creditors.”).

95 N.Y. E.P.T. L. § 7.2-4.

96Pooling and Servicing Agreement, Securities Asset Backed Receivables LLC Trust 2005-FR3, § 2.01(b), July 1, 2005, *available at*

http://www.secinfo.com/dRSm6.z1Fa.d.htm (“The Depositor, concurrently with the execution and delivery hereof, hereby sells, transfers,

assigns, sets over and otherwise conveys to the Trustee for the benefit of the Certificateholders, without recourse, all the right, title and interest of

the Depositor in and to the [mortgage notes].”)

97 Vincent v. Putnam, 248 N.Y. 76, 84 (N.Y. 1928) (“Mere words never constitute a delivery.”).

98 Pooling and Servicing Agreement, Securities Asset Backed Receivables LLC Trust 2005-FR3, § 2.01(b), July 1, 2005, *available at*

http://www.secinfo.com/dRSm6.z1Fa.d.htm. Deal language may vary, and some PSAs merely require endorsement in blank, not the chain of

endorsements on the note. *See, e.g.*, Pooling and Servicing Agreement, Asset Backed Finance Corp. 2006-OPT- 1 Trust, July 1, 2006, *available*

*at* http://www.secinfo.com/dRSm6.v2K1.c.htm#8mq6 (requiring delivery to the trustee of “the original Mortgage Note, endorsed in blank or with

respect to any lost Mortgage Note, an original Lost Note Affidavit, together with a copy of the related Mortgage Note” but not of intervening

endorsements.).

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***D. COMPLIANCE***

Regardless of the legal method that applies for transferring notes and mortgages, there is a

question of whether there was compliance with that method in actual securitization deals. The

American Securitization Forum white paper says nothing on this count, nor can it; evaluating

compliance would involve examining actual loan files. This is something that federal bank

regulators should be doing, and I would urge the Committee to underscore that point in

conversations with the regulators.

There are, of course, a multitude of potential non-compliance problems, including the

premature shredding of notes99 or the signing of assignments by purported agents of now-defunct

companies. The scope of these problems is unclear; they may plague individual deals or just

individual loans within those deals. On the other hand, if the PSAs set forth the transfer

requirements, there may well be widespread non-compliance with the endorsement requirements

of the PSAs. Most notes contain only a single endorsement in blank, not “all intervening

endorsements showing a complete chain of endorsement from the originator to the last endorsee”

before a final endorsement in blank. This would appear to mean that such transfers are void

under New York law and that the mortgages were never actually transferred to the trusts issuing

the MBS and this could not be corrected because of various timeliness requirements in PSAs.

It bears emphasis that the validity of transfers to the trusts is an unsettled legal issue. It is not as

clear as either the American Securitization Forum or any law firm with outstanding securitization

opinion letter liability would have one believe. There are questions both about what law actually

governs the transfers and about whether there was compliance with the law. If there is a

widespread chain of title problem, however, it would create a systemic crisis, as title on most

properties in the US would be clouded and the contract rescission/putback liability because of the

failed transfers would greatly surpass the market capitalization of the country’s major banks.

**IV. YES, BUT WHO CARES? THESE ARE ALL DEADBEATS**

***A. DOES BANKS’ CONVENIENCE TRUMP RULE OF LAW?***

A common response from banks about the problems in the securitization and foreclosure process

is that it doesn’t matter as the borrower still owes on the loan and has defaulted. This “No Harm,

No Foul” argument is that homeowners being foreclosed on are all a bunch of deadbeats, so who

really cares about due process? As JPMorganChase’s CEO Jamie Dimon put it “for the most part

by the time you get to the end of the process we're not evicting people who deserve to stay in

their house.”100

99 *See* Florida Bankers’ Ass’n Comment to the Florida Supreme Court on the Emergency Rule and Form Proposals of the Supreme

Court Task Force on Residential Mortgage Foreclosure Cases, at 4, *at* http://www.scribd.com/doc/38213950/Notes-Are-Destroyed (“The reason

‘many firms file lost note counts as a standard alternative pleading in the complaint’ is because the physical document was deliberately

eliminated to avoid confusion immediately upon its conversion to an electronic file.”).

Mr. Dimon’s logic condones vigilante foreclosures: so long as the debtor is delinquent, it

does not matter who evicts him or how. (And it doesn’t matter if there are some innocents who

lose their homes in wrongful foreclosures as long as “for the most part” the borrowers are in

default.) But that is not how the legal system works. A homeowner who defaults on a mortgage

doesn’t have a right to stay in the home if the proper mortgagee forecloses, but any old stranger

cannot take the law into his own hands and kick a family out of its home. That right is reserved

solely for the proven mortgagee.

Irrespective of whether a debt is owed, there are rules about who can collect that debt and how.

The rules of real estate transfers and foreclosures have some of the oldest pedigrees of any laws.

They are the product of centuries of common law wisdom, balancing equities between borrowers

and lenders, ensuring procedural fairness and protecting against fraud.

The most basic rule of real estate law is that only the mortgagee may foreclosure.

Evidence and process in foreclosures are not mere technicalities nor are they just symbols of rule

of law. They are a paid-for part of the bargain between banks and homeowners. Mortgages in

states with judicial foreclosures cost more than mortgages in states without judicial oversight of

the foreclosure process.101 This means that homeowners in judicial foreclosure states are buying

procedural protection along with their homes, and the banks are being compensated for it with

higher interest rates. Banks and homeowners bargained for legal process, and rule of law, which

is the bedrock upon which markets are built function, demands that the deal be honored.

Ultimately the “No Harm, No Foul,” argument is a claim that rule of law should yield to

banks’ convenience. To argue that problems in the foreclosure process are irrelevant because the

homeowner owes *someone* a debt is to declare that the banks are above the law.

***B. ARE THEY ALL DEADBEATS?***

Not every homeowner in foreclosure is a deadbeat. There are some homeowners who are in

foreclosure while current on their mortgages, others who are in foreclosure after having been told

by their servicers that they have received loan modifications, and others who are in foreclosure

because of warehouse lending fraud problems whereby their original lender sold their same

mortgage multiple times. There are also homeowners who are in foreclosure because of

predatory servicing practices such as charges for forced-placed insurance at way-above-market

rates and misapplication of payments (such as illegally applying payments first to late fees and

then the principal and interest owed so as to make the payment only qualify as a partial payment,

thus incurring another late fee). These homeowners are hardly deadbeats; they are in foreclosure

not because of their own behavior, but because of their servicer’s behavior.

Ultimately, we don’t know how many homeowners in foreclosure are truly in default on

their mortgages. To actually determine that would require a detailed examination of

homeowners’ payment history, an examination that would take several hours in most cases, and

homeowners currently lack the right to receive servicing statements showing how their payments

are applied

100 Tamara Keith & Renee Montaigne, *Sorting Out the Banks’ Foreclosure Mess*, NPR, Oct. 15, 2010.

101 *See* Karen Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177 (2006) (noting that

the availability—and hence the cost—of mortgages in states with judicial foreclosure proceedings is greater than in states with non-judicial

foreclosures).

A servicer’s assertion that the homeowner is delinquent is not conclusive evidence,

especially if the assertion is in a robosigned affidavit. Most homeowners in foreclosure are likely

in default, but given that most homeowners lack legal representation, we should be cautious in

assuming too much. Sometimes a default judgment is an admission that the plaintiff is correct,

and sometimes it is just a sign of lack of resources to litigate.

**V. CONCLUSION**

The foreclosure process is beset with problems ranging from procedural defects that can be

readily cured to outright fraud to the potential failure of the entire private label mortgage

securitization system.

In the best case scenario, the problems in the mortgage market are procedural defects and they

will be remedied within reasonably quickly (perhaps taking around a year). Remedying them will

extend the time that properties are in foreclosure and increase the shadow housing inventory,

thereby driving down home prices. The costs of remedying these procedural defects will also

likely be passed along to future mortgage borrowers, thereby frustrating attempts to revive the

housing market and the economy through easy monetary policy.

In the worst case scenario, there is systemic risk, as there could be a complete failure of

loan transfers in private-label securitization deals in recent years, resulting in trillions of dollars

of rescission claims against major financial institutions. This would trigger a wholesale financial

crisis.

Perhaps the most important lesson from 2008 is the need to be ahead of the ball of

systemic risk. This means (1) ensuring that federal regulators do a serious investigation as

discussed in this testimony above and (2) considering the possible legislative response to a crisis.

The sensible course of action here is to avoid gambling on unsettled legal issues that could have

systemic consequences. Instead, we should recognize that stabilizing the housing market is the

key toward economic recovery, and that it is impossible to fix the housing market unless the

number of foreclosures is drastically reduced, thereby reducing the excess inventory that drives

down housing prices and begets more foreclosures. Unless we fix the housing market, consumer

spending will remain depressed, and as long as consumer spending remains depressed, high

unemployment will remain and the US economy will continue in a doldrums that it can ill-afford

given the impending demographics of retirement.

This suggests that the best course of action is a global settlement on mortgage issues, the key

elements of which must be (1) a triage between homeowners who can and cannot pay with

principal reduction and meaningful modifications for homeowners with an ability to pay and

speedier foreclosures for those who cannot, (2) a quieting of title on securitized properties, and

(3) a restructuring of bank balance sheets in accordance with loss recognition.

A critical point in any global settlement, however, must be removing mortgage servicers

from the loan modification process. Servicers were historically never in the loan modification

business on any scale, and four years of hoping that something would change have demonstrated

that servicers never will manage to successfully modify many loans on their own. They lack the

capacity, they lack the incentives, and the lack the will.

[**Countrywide Class Action Lawsuit**](http://financeclassactionlawsuit.com/countrywide-class-action-lawsuit.html)

February 27th, 2011 by Admin

A judge approved a **Countrywide class action lawsuit** settlement in Federal Court this week.  The settlement was worth over $600 million, and represents one of the largest financial class action lawsuits to stem from the subprime mortgage fiasco of the past few years.  The company is now owned by Bank of America, who is of course involved in the settlement and setting aside of funds to settle cases against the company.

The **Countrywide Class Action Lawsuit** was brought by plaintiffs who allege they were mislead about the company’s financial status.  Specifically, they allege they were mislead about Countrywide’s lending practices and about the financial condition due to involvements in risky lending behavior…subprime mortgages to be exact. Spokespeople for Bank of America said they have agreed to settle the **Countrywide Class Action Lawsuit** in order to offset litigation costs and continuing uncertainty about the case.   They have agreed to set aside funds for future possible cases, should investors who have opted out of the current **Countrywide Class Action Lawsuit** settlement, decide to file suits.

Some of the major investors in Countrywide have indeed opted out of the current **Countrywide Class Action Lawsuit**, including several public employee retirement management companies.  They may decide to file **Countrywide Class Action Lawsuits** in the future, which is why Bank of America has set aside the above-mentioned funds, to the tune of $22.5 million.  In all, there are around 30 major investors who opted out of the current suit, meaning the current **Countrywide Class Action settlement** will not cover these investors.

**Bank of America hit with class action foreclosure lawsuit**



Bank of America class action suit

Newscast Media — Bank of America has been hit with a class action on behalf of homeowners seeking damages for alleged disregard of foreclosure process rules. The suit, filed Wednesday in federal court in Newark, N.J., accuses Bank of America and two subsidiaries, LaSalle Bank and BAC Home Loans Servicing, of “an undisciplined rush to seize homes” through “pervasive and willful disregard of knowledge, facts and statutes.”

Bank of America has filed foreclosure proceedings on many mortgages in New Jersey without holding the necessary rights as the mortgagee or assignee at the time of foreclosure, the suit says.

“Many thousands of foreclosures are plainly void under statute and settled New Jersey case law. Many borrowers never obtain statutorily required notices, and many foreclosure suits are filed entirely based in inaccurate recitations concerning ownership of the mortgage, the note, or the assignment,” the suit says.

The putative class in the suit, [**Beals v. Bank of America, N.A., 10-cv-05427**](http://www.scribd.com/doc/40029412/Bank-of-America-Class-Action-Beals-v-Bank-of-America-N-a-10-Cv-05427), consists of all named defendants in pending New Jersey foreclosure actions initiated by Bank of America or its affiliates. The complaint includes counts of common-law fraud, breach of the covenant of good faith and fair dealing and violations of the New Jersey Fair Foreclosure Act and Consumer Fraud Act. The plaintiffs cite a recent, well-publicized admission by a Bank of America official in a Massachusetts foreclosure case that she signed thousands of foreclosure complaints without reviewing them.

They also say the fact that the bank and its affiliates, by imposing a moratorium on foreclosures from Oct. 8 to Oct. 18 while reviewing their procedures, “have admitted that in all of their foreclosure cases, they, as a moving party, prosecute their claims with a complete disregard of whether or not they have met their burden.”

The plaintiffs claim they are entitled to compensation for emotional distress, damage to their credit scores and time lost from work for attorney meetings and foreclosure proceedings.

They also seek punitive damages and attorney fees as well as declaratory and injunctive relief dismissing the foreclosures of class members, with prejudice, declaring the mortgages and promissory notes of class members void and unenforceable` and rescinding or reforming the mortgages and promissory notes to conform to plaintiffs’ reasonable expectations.

The suit was brought by Lawrence Friscia, head of a Newark firm that counsels distressed homeowners, and his associate, Jonathan Minkove, who say they’ve found that Bank of America regularly negotiates binding agreements to modify mortgage terms and then fails to honor the terms.

The seven named plaintiffs are all New Jersey residents in danger of foreclosure, among them Jose Grullon of Passaic, N.J., whose binding arbitration agreement ending his foreclosure was ignored by Bank of America, and Tanya Beals of Roselle, N.J., who received a mortgage modification but was nonetheless found in default by Bank of America when she made mortgage payments at her new, reduced rate.

“There’s a difference in the fact pattern [among individual cases] but there’s pattern and a practice of blatant disregard for process,” says Minkove. “Any lawyer who’s worth his salt will tell you process matters.”

And when judges call them to case management conferences in their foreclosure cases, outside counsel for Bank of America regularly fail to show up, says Friscia. Worse still, New Jersey’s judges don’t seem to be bothered by such behavior, he says.

“There’s a shocking deference given to Bank of America on the part of the judicial system,” Friscia says.

In the firm’s negotiations on behalf of homeowners, the bank doesn’t bargain in ood faith, says Minkove. For example, the legal department will tell them to speak to the loss mitigation department, which will order them to send in send in documentation. They comply, but bank officials “regularly say they never received it. Therefore, part of what prompted us to action is [the realization that] this is a systemic problem. The left hand doesn’t speak to the right hand,” Minkove says.

A Bank of America spokesman in New York, T.J. Crawford, referred a reporter’s inquiry about the suit to other spokespersons in California, who did not respond to telephone and e-mail messages.

The case has been assigned to District Judge Katharine Sweeney Hayden.

[**http://newscastmedia.com/bofaclassactionsuit.htm**](http://newscastmedia.com/bofaclassactionsuit.htm)