Rortybomb

For Respecting Contracts and Not Respecting Contracts in the Foreclosure Fraud Crisis.

Posted in Uncategorized by Mike on November 22, 2010

David Dayen has an interview with Congressman Brad Miller, "Protecting bank solvency has been a goal of Treasury that I do not share", that you should check out. Brad Miller is at the front of the foreclosure fraud crisis, recently signing a letter urging the newly created FSOC council of regulators to meet to investigate the servicer issues.

Here's a fun point he brings up:

> Q: Do you get the sense that Republicans are paying attention to this issue at all? What will they do with it in the majority?
>
> Rep. Miller: Blame borrowers. Or, I'm sure they're going to find some way to argue that it's all government's fault, liberals' fault. I'm sure they're scrambling. They probably have a full team at AEI and Cato working on that now. They'll have some experts with a complete explanation come January.

Heh. I wonder what the conservative/libertarian line will be on the whole topic. I don't know, but I do have some questions on conflicting thoughts I've seen. I'm going to use the writings of Mark A. Calabria, who runs Cato's financial regulation studies, though I've seen this from many. Here's Calabria, May of 2009, writing after cramdown ('lien stripping' or mortgage modification in bankruptcy) failed, With 'Cramdown' Rejection, Is Senate Ready to Respect Marketplace Contracts Again?:

> After rejecting the proposed 'cramdown' changes to the bankruptcy code, the Senate may be slowly waking up to the need to respect contracts. One cannot rebuild trust and confidence in our markets, while at the same time trying to destroy the trust that underlies contractual relations. Were the cramdown legislation approved, the message to investors, or any market participants, would be that the enforceability and terms of your private agreements will be subject to the direction of the political winds.

Mike here. The most important thing here is that contractual relations are enforceable, not subject to whims or the winds of politics or power. Even though our system of property rights and secured credit are deeply embedded in our laws, if two people made a contract over a mortgage under a regime of the law to then change that law, bankruptcy or otherwise, would insult our system of marketplace contract and introduce all kinds of moral hazard into the equation. Even if it would involve fixing a disastrous collection of conflicts-of-interest and agency problems among the servicers, problems that are going straight to the bottom line of investors through junk fees and to the cohesion of neighborhoods through bad-faith modifications, contracts are contracts, and we must carry them out.

And I'm certain that this is consistent. If it turned out that banks and mortgage originators cut corners by not passing along the notes, violating Pooling and Service Agreements and trust law, they'd have to eat the losses. If it turned out they didn't pass along the notes, and couldn't foreclose without "actively" seeking out those notes which would violate trust law, that's their problem. The moral hazard of changing the rules for the banks or turning a blind eye to this activity would be deafening, and Lord have mercy on anyone who would violate the sanctity of the courts by bringing in fake documents to provide standing to foreclose. Am I right or am I right?

Calabria on October 14th, 2010, White House Right to Oppose Moratorium (my bold):

> Whatever mistakes might have been made by lenders do not change the basic fact: most foreclosures are happening because the borrower is not paying the mortgage…Of course, in the small number of cases where a real mistake has been made and a foreclosure is moving forward against a borrower who is current on their mortgage, the courts have the ability to stop that from proceeding. In judicial foreclosure states the easiest solution to this problem is for the judge to ask the borrower, "When was the last payment you made?" If it has been awhile, say over six months, then the foreclosure should proceed, and proceed quickly… And if we ever expect or hope to see private capital come back into the mortgage market, then government needs to stop threatening to steal away that capital once it's invested. **The current efforts by states to use technical mistakes by lenders to allow borrowers to remain in homes** without paying could ultimately undermine the very concept of a mortgage: that it is a loan secured by property. Instead, we risk seeing mortgages turned into another form of unsecured lending, which would raise interest rates for everyone.

Four points:

1. There is no Foreclosure Batman. There are no vigilante foreclosures. If you tell me that you aren't paying your mortgage, and I don't own the mortgage and the note, I can't kick you out of your house. That's basic. If you aren't the mortgagee, you don't have a direct interest in the outcome, therefore you can't bring a suit. This is not a technicality to be hand-waved away. We are dealing with laws surrounding secured credit and trust law, two fields where strict requirements are essential. These are the dot-the-i's cross-the-t's fields, fields where it has long been established that these things matter.

2. And to now hand-wave it all away would generate a massive amount of moral hazard for the banking industry, a bailout on par with TARP. Going back to 1928, New York trust law is very strict on how assets get into a trust ("Mere words never constitute a delivery", see also Section III here). There's a century of very strict and clear rules in how to set up a trust, and the PSA's all these institutions signed were even clearer.

3. Calabria suggests that we toss out the process of judicial foreclosures in the states that have it, replacing it with a 'current or no?' style question and get foreclosures to "proceed, and proceed quickly." Calabria doesn't suggest how he'd compensate homeowners for this taking. Having a court vet your foreclosure is like buying an embedded option in your mortgage, and like any option you pay for it. Karen M. Pence, of the Board of Governors of the Federal Reserve System, has an excellent paper, Foreclosing on Opportunity: State Laws and Mortgage Credit, that lays out quite clearly that mortgage lenders price in the costs of judicial bankruptcy in states where it exists.

States have different markets for housing; the housing market in Ohio is not Florida is not Texas is not California. It is appropriate and wise that state governments exercise a federalism in writing foreclosures laws tailored to their local markets, and then having capital markets price that in accordingly. To just hand-wave away a legal option that consumers are paying for isn't right, especially when there are allegations of fraud across the entire securitization industry.

(4. Also, private capital and investors hate cramdown? Someone should tell this Blackrock Vice-President, who went to the Wall Street Journal op-ed page and called for cramdown in light of all the foreclosure fraud

we are seeing. Remember: cramdown protects investors and capital from the abuses of servicers and banks working as middlemen, abuses that we learn more and more about each day.)

But ultimately those who thought we need to respect contracts and the law when it came to opposing cramdown now have to consider that respecting contracts might mean trustees have no standing to foreclose. Respecting contracts when it hurts for investors and borrowers, but wanting to give leeway for contracts when it protects the largest banks and servicers. How's that for a dilemma?

1 comment

« Countrywide Never Sent Mortgages to Trust, Now With Helpful Chart.

One Response

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1. **Andrew** said, on November 22, 2010 at 10:30 am

   I like the idea of "Foreclosure Batman," though I suspect many on the Right would prefer a "Foreclosure Dirty Harry"

   FDH: You come to me, snivelling "where's the note, do I have all the paperwork, do I have standing… you and your type are scum, you're deadbeats. I don't need a stinkin' note. I just need ….. this!" [Commits gratuitously violent act involving large firearm. Audience cheers]

   In a different universe, Tanta enjoyed a full recovery from cancer, and has blogged the last three years at Calculated Risk, and we all are not only better informed but have made tiny little changes that are going to fix this. Her archives are a cornucopia of nudges and warnings about what we're seeing now:

   http://www.calculatedriskblog.com/2007/11/deutsche-bank-fc-problems-and-revenge.html

   On the one hand, mistakes just do get made, in any business. On the other hand, the mortgage industry's back room got incredibly sloppy during the boom. You had experienced closing and post-closing staff laid off and replaced by temps who don't know an endorsement from a box of Wheaties, you had loans being sold by brand-new entrants into the business with no experience in these legal transactions, you had gigantic pressures to move loans through the pipeline into a security as fast as possible and paperwork be damned, you had a business too comfortable working on reps and warranties and indemnifications–on a promise to make it good if it ever blows up rather than fixing it now. You had regulators of big depositories that were sound asleep when it came to such operational "trivia."