

The drastic financial events of the past three years began with the collapse of sub-prime U.S. mortgages triggering the financial tsunami that spread throughout the world. In the crisis that erupted in late 2007 there were clear and fundamental signs that were simply ignored by people who should have been paying attention. While the world strives to recover from the most devastating financial blow since the Great Depression, a deeper, perhaps even more viscous blow may yet be looming. The rapidly developing series of events in the U.S. mortgage industry has advanced concerns that a breakdown could rock global financial markets as never before.

Foreclosures Foreshadow Financial Collapse

This risk to the global markets stems from a DNA of fraud shot through the U.S. mortgage industry. It begins with loan originations routing through the methods used by lenders and their agents in the mundane recording of notes and mortgages at the county clerk’s office and ends in the processing of millions of property seizures through foreclosure.

Meanwhile the effect on the US residential property industry could be severe. If the halt on foreclosures now under way continues to spread, determining the market value that applies to the purchase, sale or financing of homes could become difficult. In some cases homeowners who lost their property in a foreclosure could sue to recover their property creating more confusion among investors and problems for title insurers.

“Collateralized Debt Obligations”: The Chosen Instrument of Financial Failure

In the past ten years more than \$1.8 trillion in U.S. mortgages have been securitized as collateralized debt obligations or “CDOs” also known as asset-backed securities, or “ABSs”.ⁱ Global banks spread CDOs placing them in their own portfolios and on the balance sheets of institutions worldwide including insurance companies, mutual funds, unit trusts, investment trusts, commercial banks, investment banks, pension funds, private banks, and even other CDOs.ⁱⁱ

What makes a security secure is the asset behind it. In the case of residential mortgage loans two items offer that security, the property and the promise of the borrower to make payments. If the borrower breaks the promise to pay, the property can be seized through the foreclosure processes. But events are moving swiftly in courts, state governments and in Washington regarding legal issues, mechanisms and processes that broaden the chances that lenders will not be able to take the pledged property leaving CDOs with only the borrower’s signature as security. This provides little comfort when the loan is in default. The value of a non-performing signature loan is only a fraction of a secured debt.

If the global financial markets conclude that these ABSs have lost the security of pledged U.S. real estate, the value of the assets on the balance sheets of the institutions could drop sharply. This could cause pension funds to miss payments and insurance companies to stop paying on claims. Overnight, banks could be undercapitalized and a new round of bailouts might be necessary to avert a second, more damaging, financial crisis.

Connecting the Dots: Significant Recent Legal and Financial Events

- **Sept. 20, 2010:** Ally Financial, once known as GMAC and 56% owned by the United States Treasury, halted evictions and resale of repossessed homes in all 23 states where foreclosures require court approval.ⁱⁱⁱ
- **Sept. 24, 2010:** Chairman Barney Frank and two other members of the powerful House Financial Services Committee sent a letter to FNMA, now under U.S. Government conservatorship, on their use of “foreclosure mills”. FNMA together with FHLMC together own or guarantee more than half of the \$12 trillion of mortgages in the U.S.^{iv}
- **Sept. 28, 2010:** JP Morgan Chase one of the four largest banks in America halted foreclosure on 56,000 homes in the 23 states where courts must approve foreclosures.^v
- **Sept. 29, 2010:** The U.S Office of the Comptroller of the Currency told seven banks to review their foreclosure procedures after recent revelations found errors and possible instances of fraud in handling homeowner evictions. Contacted were: JP Morgan Chase, Bank of America, Citigroup, HSBC, PNC Financial, U.S. Bancorp and Wells Fargo.^{vi}
- **Sept. 30, 2010:** Ohio Secretary of State Jennifer Brunner asked the U.S. Attorney General to investigate notaries public who have handled documents in foreclosure cases brought by JPMorgan Chase & Co. and Mortgage Electronic Registration Systems. Documents uncovered in court records show that signatures have been notarized far before or far after the date of the document and, in some cases, signatures appear to have been forged.^{vii}
- **Oct. 1, 2010:** Connecticut Attorney General Richard Blumenthal stopped all foreclosures from all banks in his state^{viii}. Separately, Bank of America announced a delay in foreclosures in those same 23 states that require court approval of a foreclosure.^{ix}

- **Oct. 4:** The Attorney General of Texas writes to 30 lenders demanding that they stop evictions, foreclosures and forced sales of seized properties and await a review of practices.^x

- **Oct. 5:** The speaker of the U.S. House of Representatives and 30 other members of Congress wrote to the Justice Department, the OCC and the Federal Reserve Bank requesting an investigation into lenders foreclosure practices.^{xi} Separately, four members of the U.S. Senate wrote to 120 banks and loan servicers, the Government Accountability Office, the Secretary of the Treasury, and others to open investigations and get answers to growing claims of foreclosure fraud.^{xii}

- **Oct. 6:** The Attorney General of Massachusetts asked Bank of America, JPMorgan, GMAC and Wells Fargo & Co. to suspend foreclosures and evictions in her state.^{xiii} Separately, The Attorney General of North Carolina announced an expanded investigation of possible foreclosure fraud to include 14 additional lenders.^{xiv}

- **Oct. 7:** U.S. Rep. Edolphus Towns chairman of the House Committee on Oversight and Government Reform, called on top banks to suspend foreclosures. He asked the New York attorney general, where many lenders are based, to investigate foreclosure practices.^{xv}

“Errors, Mistakes, Mishandling”: It’s just One Big Financial Mess

Whether termed errors, mistakes, or mishandling, documents submitted to courts in support of seizure are at the root of this part of the foreclosure mess. In sworn testimony officers for lenders and loan servicers disclosed that key affidavits were false^{xvi}.

Because mortgages are readily sold and resold, in some cases the chain of ownership of security as standing to foreclosure may be lost or impossible to document. “The banks will now be forced to prove they actually hold the mortgage and note before they can foreclose,” said Lori Barkus, a foreclosure defense lawyer in Weston, Florida. “If banks cannot come up with the actual note, or prove that the note was assigned to them, which, in most cases, they cannot, then the foreclosure action must be dismissed.”

In the confusion homeowners wishing to sell the property could be blocked. “The homeowner cannot prove clear title either,” Barkus said, “in order to sell, the homeowner would need to be able to transfer title to the new owner and can’t because there is a mortgage and promissory note out there.”

Foreclosure Practices Investigated

Attorneys general in at least seven states have opened investigations into foreclosure practices. Lawyers for homeowners charge that each false affidavit represents a separate act of fraud numbering into the tens of thousands monthly. These lawyers are filing numerous lawsuits against lenders, servicers and the law firms that process the foreclosures.

The already overburdened legal system is unable to keep up with the tide of foreclosures. More than 4½ percent of U.S. mortgages are in foreclosure and more than 9½ percent are in default.

In Florida where 1 in 5 mortgages are seriously delinquent, special foreclosure courts have been set up in the hallways of courthouses with retired judges called in to clear up the backlog. The average foreclosure hearing in a Florida court is 90 seconds and some attorneys report that some of the retired judges hearing these cases have issued their judgment without examining the files or hearing from homeowners' counsel. Jason Grodensky, a Fort Lauderdale, Florida homeowner was surprised to learn that Bank of America had foreclosed on his property because he purchased for cash and had no mortgage. While judges can be brought in *ad hoc* in special circumstances, the Florida state constitution requires that judges be elected and some expect challenges to these rulings on constitutional grounds.

A Loan Explosion: Rampant Fraud Rides Along

In the last decade when the volume of loans exploded the likelihood of fraud rode along. Borrowers were offered loans without having to verify any capacity to repay beyond the ability to sign their names. In what have come to be called NINJA loans (no income, no job or assets) borrowers have defaulted at very high rates. Open incidents of fraud beyond the elastic borders of the NINJA loans have occurred as well. In one South Florida mortgage company catering to expatriate Brazilians, new borrowers were given the social security number of a deceased person to list as their own for the better credit rating. Wall Street, hungry for mortgages to put into securitization, offered borrowers with dicey credit large sums and even took second position on vacation homes under these NINJA loans. [See Attached]

Foreclosure Buyers Turn Back Keys to Former Owners'

In the wake of the financial crises the real estate industry has seen a brisk business in the purchase of property seized by banks in foreclosure. As the pile of investigations and

charges quickly grows, there looms now the prospect that improper foreclosures could put displaced homeowners back in their home.

Those who bought the property out of a foreclosure procedure, the second owners, may have to hand back the keys. If the second owners borrowed to make the purchase they may still be liable for the loan even though the property has gone back to the original homeowner. The second owners would then file a claim with the insurance company that underwrote the title policy. On Oct. 1 shares in many title insurance companies dropped on the major exchanges.



Trading in First American Corp., a large title insurer on the NYSE since Oct.1, 2010.

The same day USA Today reported: “Old Republic National Title Insurance, among the nation's largest title insurance companies, will no longer write new policies for homes foreclosed upon by J.P. Morgan Chase and Ally Financial's GMAC Mortgage unit ---- a sign that concerns about faulty foreclosure paperwork could now endanger new sales of foreclosed homes.”

An Electronic Meltdown: Mortgage Electronics Registration System, Inc

Now another character enters the picture to amplify the complexities and tension to extraordinary, even sinister proportions. Meet MERS.

In 1999 some of the largest mortgage lenders including Wells Fargo, Countrywide and Bank of America formed the Mortgage Electronic Registration System, Inc. (“MERS”) to satisfy the rating agencies’ demand that the security interest in mortgages be held by a “bankruptcy remote” entity, a straw man. MERS has no employees, pays no salaries and is essentially a database. Where mortgage holders once manually registered their interest with the clerk of the county courts, MERS digitized mortgages and, by recording their

position as “holder” of the mortgage, frequent sales of notes and mortgages could occur without registering those transactions or paying to local governments the associated fees. In class action lawsuits filed in the past days plaintiffs charge that MERS methods were intended to avoid disclosure and mislead both consumers and local governments in violation of the law. More than 50% of all U.S. mortgages are registered in the name of MERS and more than 90% of all mortgages originated since 2005 are in the name of MERS.

Recent Legal Decisions, Evidence of Financial Disaster on the Horizon

In recent decisions in California^{xvii}, Kansas, New York and Ohio, courts have ruled that MERS lacks standing to foreclose. MERS has no assets, no income and no participation in the mortgage transaction therefore, say the courts, no right to force foreclosure. Approximately 62 million US homes may be foreclosure proof.

This week class action suits were filed in Kentucky and Florida against 15 defendants including MERS, lenders, loan servicers and the law firms that acted on their behalf in foreclosure actions.^{xviii} More such lawsuits are expected.

Where To From Here?

With so many things going wrong for lenders can the problems reach the point that the AAA securities widely distributed during the boom years go bust? Such an outcome is more likely now than ever before. Charges of rampant fraud are causing foreclosures to grind to a halt. Displaced homeowners could reverse the process as ousted investors pursue title insurers. The consequences for the residential real estate market could be dire. While seemingly expedient at the time, the use of MERS in 90% of mortgages in the past five years could result in lenders left without the ability to seize properties in loan defaults. The potential for losses in CDOs could translate into problems for holders of securities with questionable value including banks, insurers and retirement funds.

The roots of the Great Recession trace back to the sub-prime mortgage crisis in the U.S. Facing us now is the prospect that the worst is still yet to come.

###

ⁱ http://www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_GlobalCDODData.xls

ⁱⁱ IMF International Review <http://www.palgrave-journals.com/imfer/journal/v58/n1/full/imfer20103a.html>

ⁱⁱⁱ <http://www.reuters.com/article/idUSTRE68J33E20100920>

^{iv} <http://www.housingwire.com/2010/09/24/barney-frank-questions-fannie-mae-on-foreclosure-mills>

^v http://www.americanbanker.com/issues/175_188/jpmc-halts-foreclosures-1026338-1.html

^{vi} <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/30/AR2010093006563.html>

vii <http://www.dispatch.com/live/content/business/stories/2010/10/01/brunner-seeks-probe-of-notaries.html?sid=101>

viii <http://www.hartfordbusiness.com/news15043.html>

ix <http://www.usfinancialpost.com/bank-of-america-announces-moratorium-on-home-foreclosures-in-23-states/85771/>

x <http://austin.bizjournals.com/austin/stories/2010/10/04/daily51.html>

xi http://www.huffingtonpost.com/2010/10/05/democrats-call-for-invest_n_751373.html

xii <http://www.reuters.com/article/idUSTRE6944BI20101005>

xiii

http://www.boston.com/news/local/massachusetts/articles/2010/10/03/coakley_is_investigating_bank_of_america_others/

xiv <http://www.wbtv.com/Global/story.asp?S=13280789>

xv

<http://www.housingwire.com/2010/10/07/government-oversight-chairman-seeks-nationwide-foreclosure-moratorium>

xvi <http://4closurefraud.org/2010/06/16/2nd-deposition-of-jeffrey-stephan-gmacs-assignment-affidavit-slave/>

xvii <http://www.scribd.com/doc/35367042/MERS-MERS-CALIFORNIA-CASE-Rickie-Walker-Case-California-Mers-Bk-Ed-2010-FULL-SERIES-OF-FILINGS-FOR-CONVENIENCE>

xviii <http://www.scribd.com/doc/38654717/Class-Action-vs-Mortgage-Electronic-Registration-Systems-Gmac-Deutsche-Bank-Nation-Star-Aurora-Bac-Citi-Us-Bank-Lps-Et-Al>