

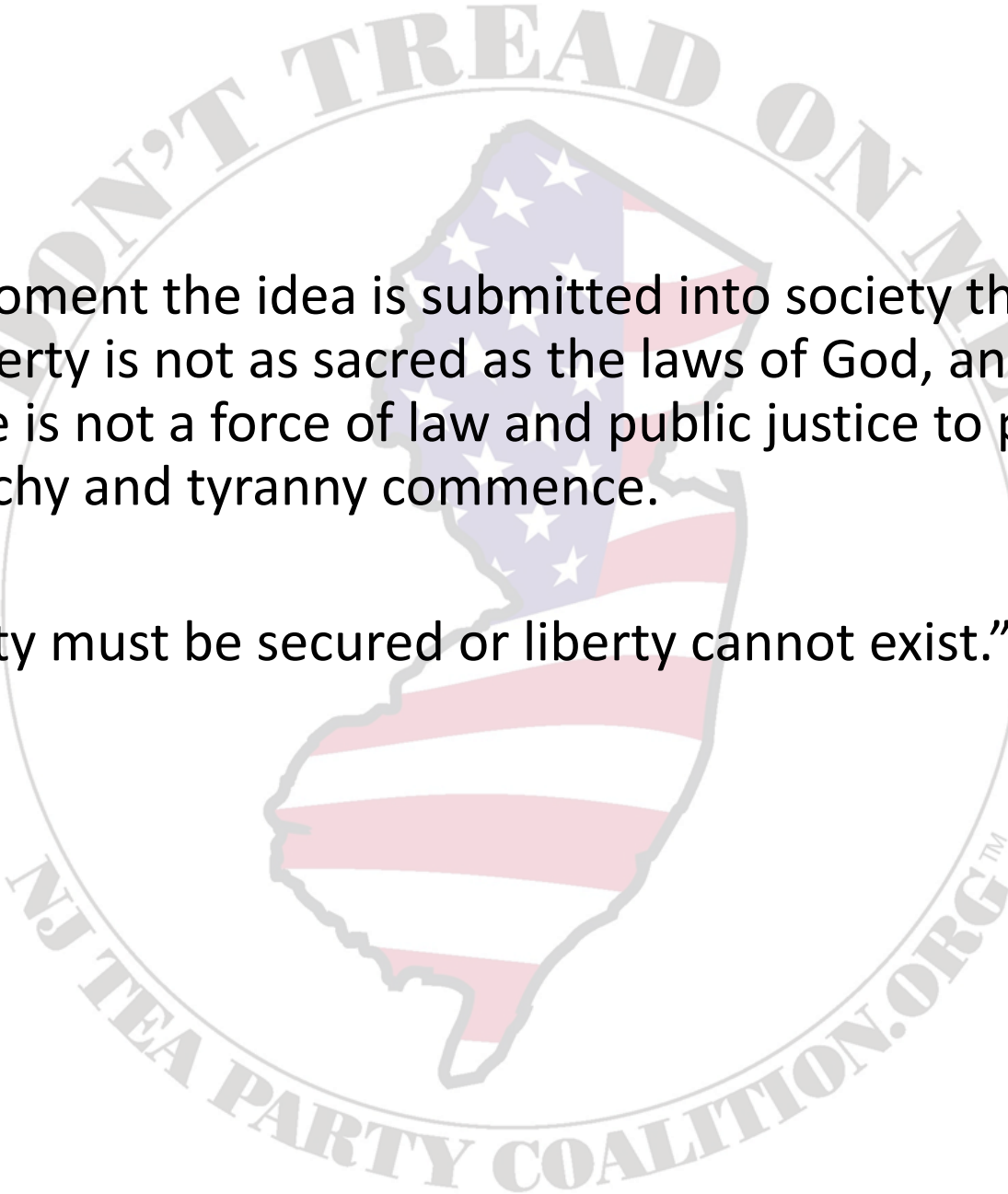
# The Specter of Mortgage Fraud

“Banks Lose Key Foreclosure Ruling in Top Massachusetts Court”

Reuters, January 7, 2011

"In their careless and hasty stampede to securitize loans, the banks moved at their own peril. They should bear the brunt and the cost of the remedy.”

Massachusetts AG Martha Coakley



“The moment the idea is submitted into society that property is not as sacred as the laws of God, and that there is not a force of law and public justice to protect it, anarchy and tyranny commence.

Property must be secured or liberty cannot exist.”

John Adams

# The State of Play

- “Foreclosuregate”, “Robo Signing”, and “Rocket Docket” describe some of the major irregularities discovered in mortgage lending since 2009, when beleaguered homeowners began to assert their rights in court.
- A growing number of State, Appellate and Federal bankruptcy courts have in fact discovered *fraud* at all levels of the mortgage transaction, including:
  - Inflated appraisals.
  - Truth in Lending Act (TILA) violations; mortgage fraud in the initial inducement.
  - Separation of note from mortgage when sold to another lender or up streamed to an MBS pool.
  - MBS Pool Servicing Agreement violations.
  - Fraud upon the courts by foreclosure attorneys, lenders, and servicers in order to re-create missing or create non-existent documentation.
  - Illegal seizure of private property.
  - Violation of Constitutionally guaranteed protection of Due Process.
- These violations of civil, contract, criminal and regulatory law were uncovered during the discovery process and in evidentiary hearings, and case law is piling up.
- MBS pools may well be at risk, which would be a national-level financial catastrophe.
- “Systemic Mortgage Fraud” may be a more accurate description of what has happened.

# Fraud? What's the Big Deal?

- Fraud in mortgage lending by itself is not shocking
  - 'No doc', 'liar' loan originations, inflated appraisals, flipping were all early signs of a problem.
  - What is new and most troubling is the systemic institutional fraud at MERS and the lost chain of ownership, which threatens personal property rights as well as the entire MBS market--25% of the US bond market.
  - The Federal government's fingerprints are all over via CRA, Fannie/Freddie, and failed regulation.
- Is this different than the scientific and regulatory Global Warming fraud?
  - Morally, it isn't, but fraud-based energy policy and subsidies can be simply ended.
  - The home mortgage cancer has already metastasized throughout the economy.
  - Clear title, a foundation of American civilization, is now clouded for many mortgages.
    - Individual property rights have been threatened, undercut, and violated.
    - American citizens are being denied Due Process.
    - Families have been wrecked.
  - The residential real estate market will be frozen, and the market won't clear.
  - Doubtful title renders all MBS suspect, no better than unsecured consumer loan debt.
    - An MBS meltdown would be massive, affecting pensions and institutional investors.
  - \$2.4 billion in recording fees is owed to counties across the US in the wake of MERS.

# Why We Are Here

- Why are we here?
  - The nation is again at risk and faces another crippling crisis that is both financial and Constitutional.
  - We must act to defuse the crisis without abrogating Constitutional rights or the primacy of private property.
  - The wrongdoing at all levels of government and private sector go unacknowledged or unpunished.
  - Bad regulation and government interventionist policies help to create this mess.
  - We don't need new laws when existing laws were broken.

# In the Beginning: MBS Overview

- Mortgage Backed Securities (MBS) are a well established capital markets instrument, well underway in the 1980s.
- They are a subset of Asset Backed Securities (ABS), wherein pools of loans or other liabilities are packaged and structured into rate-able bonds.
  - Credit card receivables;
  - Equipment leases (office equipment, machinery, railcars etc);
  - Auto loans (retail and wholesale 'floor plan' loans);
  - Manufactured housing;
  - Commercial real estate loans;
  - Consumer or home equity loans.
- MBS/ABS debt can be very creditworthy if the underlying loans are properly underwritten, because only a small percentage of individual loans will default.
- Because the internal cash flows can vary as loans are repaid or prepaid, MBS/ABS bond structures are often complex 'black boxes', with internal triggers and covenants regarding ratings, cash flows, and prepayments.
- These structures are not transparent, and are difficult to monitor compared to corporate or municipal bonds.
- Whereas mortgages used to reside in the originating banks, about 60% of US mortgages have been up-streamed and securitized into MBS.
- MBS about 25% of entire US bond market; agency MBS about 2/3 of all MBS.

# And Then Came Sub-Prime MBS

- Sub-Prime MBS is a sub-set of MBS wherein the underlying mortgages are more risky because borrowers do not meet the normal credit requirements for income, there is less equity in the home, or loan/value is weak--or a combination of all three.
- Sub-prime mortgages can still be packaged into a credit-worthy MBS structure because:
  - The loans are still secured, backed by a mortgage on real property.
  - The MBS can be ‘tranching’ into tiers of better, good, and poorer risk, wherein only the lower tier is expected to have default risk.
  - The tiers can be enhanced by third party protection, such as bond insurance.
  - Even poor homeowners treat their mortgages as sacred obligations, just like our parents did.
    - Don’t they?
- Sub-prime MBS as a class of debt didn’t exist before the 1992 Community Reinvestment Act (CRA), which required banks to make bad loans in the guise of social justice.
  - Banks were subjected to fines if they refused to make bad mortgage loans.
  - This contravened long-established and well-justified lending and underwriting practice.
  - The supply of bad mortgages naturally lent itself to MBS packaging because otherwise toxic loans could be made into a rate-able instrument suitable for pensions and other institutional investors.
  - Changed lending practices included independent appraisers separate from the lender.
- Why did no one complain about CRA?
  - Investment banks (and large businesses in general) love complex, bad regulation like CRA because it increases competitive barriers and creates opportunities for regulatory arbitrage.
  - Easier to kowtow to Federal regulators than do the right thing and commit professional suicide.
  - Fannie and Freddie were in the housing market driver’s seat and pushing CRA MBS.
- Sub-prime MBS grew to perhaps 10% of MBS overall.

# When Did It All Go Bad?

- The Fed's artificially low rates from the 1990s produced several asset bubbles-- equities, and then residential real estate-- because money became too cheap and it was easy to pile on leverage.
- The ability to manufacture AAA-rated MBS and Sub Prime MBS created a never-ending demand for mortgage 'product' for repackaging.
- The CRA created cover for shoddy and predatory lending practices.
- Everyone was in on the deal:
  - Sponsors (typically investment banks) packaging and selling the subprime MBS;
  - Rating agencies blessing the packages with strong ratings;
  - Bond insurers picking up premiums for insuring tranches;
  - Mortgage originators aggressively pushing product out the door by giving mortgages to unsuitable borrowers *who never should have been homeowners in the first place*;
  - Homeowners who saw their investment rise with the asset bubble;
  - Home flippers who used the cheap mortgages as credit cards.
- After 2006, suspicion arose in the capital markets that subprime mortgages, and even supposedly prime mortgages were even worse than they should be.
  - 'Liar' and 'No-doc' loans were an open cultural admission that something was amiss.
  - Fly-by-night mortgage origination shops, many of which have disappeared.
  - Over-inflated appraisals and home valuations.
- But, at least the underlying loans were secured by a mortgage on property.
  - Weren't they?

# It's Really Much Worse Than We Imagined

- Obviously, the burst housing bubble and the long, deep recession has hit family incomes and is causing mortgages to default.
  - Sub-prime went first, beginning in 2005.
  - Since 2009, even prime mortgages are defaulting as normally strong borrowers lose their jobs and income.
  - The MBS 'black box' models, triggers, and covenants, it turns out, assumed ever increasing home prices so these securitizations are imploding.
- But on top of this, it now appears that the chain of property ownership may have been broken in the course of MBS creation.
  - In contravention of centuries of property rights, the mortgage note was not regularly passed on from the originator through the servicer to the MBS trust.
- State courts are beginning to wake up the contravention of property law and are refusing to allow foreclosures based on suspicious or incomplete documentation.
  - The January 7 decision by the Supreme Judicial Court of Massachusetts to void home seizures by US Bancorp and Wells Fargo is a fire bell in the night.
- What happened? What else went wrong besides hastily, poorly underwritten mortgages and ill-designed 'black boxes'?

# The Central Role of MERS

- Mortgage Electronic Registration Systems, Inc was created in 1995 (activated in 1997) by large banks and Fannie and Freddie to ostensibly modernize the centuries-old system of manually recording and filing mortgages in the county where the property is located.
  - Not unreasonable on its face, similar to a wire transfer system vs. paper checks.
  - Provide lenders real-time access to mortgage information nation-wide.
  - Lower costs for servicers and borrowers, modernize inefficient county bureaucracies.
  - MERS's *real* function was to help facilitate the creation of MBS.
  - The old system was fine when mortgages stayed with the banks, but was cumbersome and costly if the mortgage was going to be changing hands perhaps dozens of times.
  - MERS now tracks about 60% of the roughly 80 million residential mortgages in the US.
- *It doesn't sound unreasonable, but...*
- Instead of truly modernizing county systems and creating an above-board national registry that complied with longstanding property law, MERS became a shell company claiming to hold the mortgages as 'beneficiary', enabling originators and MBS sponsors to buy and sell mortgages via a single entity--thereby avoid recording mortgage assignments.
  - MERS was apparently warned of flaws by county clerks as early as 1994.
- Most critically, *the mortgage note was not properly passed onto the MBS trust*, breaking the ownership chain.
- MERS has ultimately served to completely obfuscate mortgage true mortgage and property ownership.
- MERS enabled avoidance of an estimated *\$2.4 billion* in county recording fees nationally.

# An Honest But Really, Really Long Series of Mistakes, or Systemic Fraud?

- Was mortgage fraud consciously perpetrated on a massive scale through MERS?
  - MBS issuance skyrocketed after MERS went live in 1997.
  - About 65% of MBS is through Fannie and Freddie.
- Was the chain of securitization intentionally broken?
  - Countrywide officials have testified that the mortgage notes regularly *never left Countrywide as originator*
  - The 2004 Covington and Burling legal opinion attesting to the validity of MERS eRegistration system is heavily caveated as to procedural details that may not have been followed.
- Was this sloppiness, or convenient willful blindness?
  - ‘Robo Signer’ and ‘Rocket Docket’ operations do appear to be hasty attempts to paper over the problem before the fraud was discovered.
- Was the attempt to retroactively legalize MERS actions HR3808 in October 7, 2010 a similar attempt to head off a fraud discovery?
  - Pocket-vetoed by Obama, apparently at the behest of SEIU and ACORN, Elizabeth Warren.
- Why is the Fed attempting to change TILA?
  - The proposed rule would reverse the traditional understanding of TILA’s right of rescission by requiring a homeowner to pay off the entire mortgage amount before a creditor is required to cancel its security interest in the home.

# Houston, We Have a Problem

- Individual property rights have been threatened, undercut, and violated
  - Clear title and established property rights are foundations of American civilization.
  - It's what separates us from the Third World.
  - Title appears to be clouded on all mortgages in MBS--perhaps 60% of all mortgages--and perhaps all mortgages from the mid 1990s onward.
- American citizens are being denied due process as lenders ram through foreclosures.
  - The Constitution guarantees due process to everyone – not just to those with FICO scores of 750+.
  - Property rights are not reserved only for people who pay their bills on time.
- \$2.4 billion in recording fees is owed to counties across the US
  - Could MERS in part have been a tax avoidance scheme, as some have alleged?
- The residential real estate market will be frozen
  - Who will now risk buying a home if title can't be cleared?
  - Servicers are foreclosing on home and warehousing the inventory – leaving blighted neighborhoods.
  - The housing market can't 'clear', reset, and move forward.
- All MBS is now unsecured consumer loan debt, because title is doubtful
  - This has put pension and institutional investors at risk.
  - Current ratings are worthless.
  - White shoe law firms are examining MBS pools and performing forensic audits, uncovering fraud at every level of the transaction. They are sending notices to Bank of America and JP Morgan Chase that investors are demanding their money back.

# Do the Math: $MBS - M = BS$

- The potential MBS market consequence is the unexploded bomb here (that is, unless you also really care about the Constitution).
- The evidence of systemic mortgage fraud, together with state courts refusal to allow foreclosures to proceed based upon faulty documentation, at a stroke converts MBS into the equivalent of unsecured consumer loan paper.
  - MBS no longer ‘Mortgage-Backed’ at all.
  - All MBS pools are immediately suspect.
  - MBS pricing will plummet as risk has increased .
  - MERS now fighting for its life given recent court decisions.
- The real end game for the Robo-Signers and the Rocket Dockets may be heading off a collapse of the MBS market.
  - This would be a massive shock to the financial system that the US can ill afford.

# Other Players, Other Agendas

- The radical left--ACORN--is gaming up the 'fraudclosure' angle, telling adherents to break into foreclosed homes and to resist paying their mortgages.
  - This is the populist, 'it's all the fault of the bankers and capitalism' play.
  - Ultimately destructive and irresponsible.
  - Not all home borrowers are innocent victims.
- The bankers, including Fannie and Freddie, and the regulators have an interest in covering up their mistakes, and those of the long-gone originators
  - Papering over the documentation and ownership gaps via Robo-Signers and Rocket Dockets.
  - Trying to enforce foreclosures and preserve cash flow.
  - Trying to avert a banking collapse.
  - Ultimately trying to avert an MBS meltdown?
  - Some of these goals are in the larger national economic interest, but not at the expense of Constitutional rights or *punishment for wrongdoing*.
- What is The Fed up to?
  - Federal Reserve is about to change TILA in fundamental ways to preclude ordinary homeowners from obtaining judgments against predatory lenders.
- Many good-intentioned home buyers are at risk economically, but most now seem at risk in terms of property rights.
  - Congressional passage of HR3808 would obliterate states and property rights.
- Counties across the US should want to recoup their mortgage recording fees.

# Foreclosure Fraud Conceals Control Fraud

“Ask yourselves: is it possible for mortgage originators, ratings agencies, underwriters, insurers and supervising agencies NOT to have known that the system of housing finance had become infested with fraud? Every statistical indicator of fraudulent practice – growth and profitability – suggests otherwise. Every examination of the record so far suggests otherwise. The very language in use: "liars' loans," "ninja loans," "neutron loans," and "toxic waste," tells you that people knew. I have also heard the expression, "IBG, YBG;" the meaning of that bit of code was: "I'll be gone, you'll be gone."

“Control frauds always fail in the end. But the failure of the firm does not mean the fraud fails: the perpetrators often walk away rich. At some point, this requires subverting, suborning or defeating the law. This is where crime and politics intersect. At its heart, therefore, the financial crisis was a breakdown in the rule of law in America.”

Statement by James K. Galbraith, Lloyd M. Bentsen, Jr. Chair in Government/Business Relations, Lyndon B. Johnson School of Public Affairs, The University of Texas at Austin, before the Subcommittee on Crime, Senate Judiciary Committee, May 4, 2010.

# America Needs a 'Mortgage Truth and Reconciliation Commission'

- How do we otherwise acknowledge the wrong doing, the violation of laws and Constitutional rights at all levels of the mortgage process?
  - Originators, appraisers, servicers (especially MERS);
  - Bankers and sponsors, including Fannie and Freddie; rating agencies;
  - Government regulators, including those in Congress overseeing Fannie and Freddie;
  - Borrowers and would-be home purchasers who were naïve, greedy, or both.
- How do we move forward without excessive new regulation?
  - Remember that this *couldn't have happened* without government involvement through:
    - CRA;
    - Fannie and Freddie;
    - The Fed's interest rate policies;
    - Cuomo's role at HUD pushing 'affordable' mortgages.
- How do we restore risk and personal responsibility to enterprise?
  - Homeownership is serious and is not for everyone.
  - Pre-CRA 20% down bank lending was well founded and *wasn't broken until CRA broke it*.
  - If lenders fail to do their underwriting diligence their loan should be at risk.
  - If borrowers fail to honor their mortgages their pledged property should be at risk.
  - If institutional buyers of MBS fail to do their credit analysis their principal should be at risk.
- *Bailouts and government intervention only perpetuate moral hazard.*

# What Would the 'Ethical Man' Do?

- If you consciously entered into a mortgage transaction for a loan to buy a home, you intentionally pledged the real property as collateral.
  - You still owe on the loan, and the lender has your home as collateral.
- If the original deed or mortgage had been lost in a fire, it would simply and legally be recreated.
- The 'Ethical Man' argument holds that in this crisis of clouded title, mortgage holders should still pay the principal and interest owed, but to a temporary escrow account until the proper ownership chain is sorted out.
  - Massive foreclosure is in no one's interest.
  - Improper foreclosure is a violation of Constitutional rights.
  - We can't risk the complete collapse of the banking system.
  - We can't risk the melt down of MBS assets held by pension funds and institutional investors worldwide.
- But--
  - What about the homeowner served with foreclosure papers that paid cash for their home?
  - What about the mortgage holder presented with claims from several lenders for a single loan?
  - The 'Ethical Man' solution is vulnerable to gamblers - who will hide behind clouded title, squat, and not repay loans.
  - If foreclosures are delayed or temporarily suspended, until the ownership chain can be *established--why should anyone pay their mortgage?*
  - How can the balance be found?

# Constitutional Solutions: Federal Level

- DO NOT pass any new laws or regulations.
  - Americans know what will cover up fraud or the past actions of Big Government and Big Banks.
- Shut down MERS but don't create a new bureaucracy.
  - All property sales and land transfer transactions recorded at the county level as before.
  - Work with county recorders to create most efficient way to transfer all MERS files to their offices/databases
- Clean House.
  - Fannie and Freddie senior executives to step down
  - Leave of absence for ALL senior government/administration officials who have been employed by big banks, lenders, servicers and their associations over last 10 years.
  - Allow investigations to proceed at the state level under AGs to avoid Federal whitewash, yet more centralized control and intervention
- Call for a Big Six Bank Holiday.
  - Managed by FDIC
  - Conduct independent audits of lenders and servicers
  - Examine true assets and liabilities.
  - Be prepared to wind them down or break them up.
- Lead Role for Community Banks and Credit Unions.
  - Become America's primary banking system.
  - Transfer mortgages from bad actors under investigation to community banks.
  - Escrow accounts set up – consumers make payment into these accounts, serviced by community banks until property ownership and amount owed can be proved up within state courts.
- Pass Consumer Bankruptcy Laws that allow borrowers to “cram down” mortgage on primary residence.

# Constitutional Solutions: State Level

- Track One: Current borrowers and owners still in their homes
  - Establish procedure within the states' legal systems that will unravel the deals and identify true lenders.
  - Homeowners conduct work outs with real lender to negotiate principal, terms, interest rates.
  - Homeowners stay current throughout the process by sending monthly mortgage payments to escrow accounts held by local and community banks, credit unions.
  
- Track Two: People who have lost their homes through foreclosure or short sale
  - The courts look at entire picture. Did lender in fact have standing to foreclose? Did they commit fraud before the court?
  - Unravel who real lender is within separate track in state court systems.
  - People work with their real lender in mediation for principal, interest rate and terms.
  - If the borrower cannot afford the home, they walk away (perhaps credit repair becomes part of the settlement).
  - However, if real harm is evident, the borrower receives damages from foreclosing lender/bank, whether they remain in the home or not - courts decide based on facts.
  
- Track Three: Buyers of REO properties and properties in sheriff sale
  - Buyers need verification that they are in fact true owner and that title isn't clouded.
  - Go through lender-identification system as above in state court systems.
  - State court has discretion of courts to provide relief or damages based on the rule of law.

# Is America a Nation of Laws, or of Men?

Isn't it time to restore

- the Rule of Law?
- States Rights?
- Property Rights?
- Due Process?
- We the People will settle for nothing less

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