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Testimony of

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I appreciate the opportunity to address the Congressional Oversight Panel on foreclosure mitigation. I am a law professor with expertise in consumer credit, consumer protection regulation, and mortgage servicing. I have been conducting research on problems with mortgage servicing practices since 2005.

My testimony focuses on how the allegations of legal errors in the foreclosure process may impact the housing markets, the soundness of banks, and the overall financial markets. I describe the legal and economic issues involved in impermissible or flawed foreclosures and then set out the possible responses to such wrongdoing. Specifically, I consider the ways in which systemic foreclosure problems may set off extensive and complex litigation, destabilize the housing market, and result in regulatory interventions. I believe that the foreclosure process lacks integrity in an unacceptable number of ways and instances and that these problems undermine foreclosure mitigation efforts.

Foreclosure Moratoriums

On or shortly before September 20, 2010, GMAC Mortgage told its agents to halt foreclosure sales and evictions on foreclosed properties in 23 states.¹ GMAC Mortgage is a division of Ally Financial. Under the TARP program, the predecessor of Ally Financial, GMAC, estimated to have received \$17 billion of government funds during the financial crisis. The announcement was apparently triggered by the public release of the deposition of a GMAC employee, Jeffrey Stephan. In questioning in a foreclosure defense case, Mr. Stephan explained his practices in completing affidavits to support motions for summary judgment in foreclosure. He stated that that he did not review the exhibits attached to the affidavit, that he did not review much of the information in the affidavit itself, and that he did not sign the affidavit in the presence of a notary. Because the affidavits stated that the affiant had verified the facts in the affidavit and bore a notarization seal, the affidavits were false. Courts and homeowners were misled by the affidavits to believe that GMAC had verified facts relevant to the foreclosure when in fact they had not done so. Mr. Stephan's admission exposed GMAC Mortgage to court sanctions, including fines or dismissal of pending foreclosure cases, for perjury. The practices of GMAC Mortgage employees, and other servicers, with regard to affidavit procedures have become known as "robo-signing." The term reflects the lack of human review in the submission of affidavits to courts.

Within days of the GMAC scandal, a number of concerns were aired about deficiencies in mortgage foreclosure that went well beyond the robo-signing of affidavits. Concerns about servicing misbehavior triggered the suspension of foreclosure sales by other several large servicers. JPMorgan Chase and PNC announced moratoriums similar to GMAC's in scope. Bank of America suspended foreclosures in all states. Together the four servicers comprise 37% of the loans serviced on 1-4 unit residential dwellings.² After GMAC and other servicers' announcement of moratoriums, the capital markets began to react. Fitch released an announcement that it was evaluating its ratings of servicers based on their foreclosure practices.³ Bank stocks seemed driven down by concern about losses on foreclosure practices, either from litigation or loss severities from delays in the foreclosure process or abandonment of foreclosures.⁴

¹ Denise Pellegrini, *Ally's GMAC Mortgage Halts Home Foreclosures in 23 States*, Bloomberg (Sept. 20, 2010).

² Amherst Mortgage Insight, *The Affidavit Fiasco—Implications for Investors in Private Label Securities*, (Oct. 12, 2010).

³ Press Release of Fitch Ratings, *Foreclosure Probe to Weight on US RMBS Loss Severities, Servicer Ratings Vulnerable* (Sept. 29, 2010).

⁴ Bloomberg, *U.S. Bank Stocks Slide on Concern Over Foreclosure Inquiry*, (Oct. 14, 2010).

On October 18, 2010, Bank of America announced that it was lifting its moratorium and pursuing foreclosures again in the 23 judicial foreclosure states. It also announced that beginning on October 25, 2010, it would file 102,000 amended foreclosure affidavits.⁵ GMAC also announced the restart of its foreclosure proceedings.⁶ Citi and Wells Fargo have never announced a halt to their foreclosure proceedings.

Flawed foreclosures

Robo-signing is only one of a number of alleged deficiencies in foreclosure practices. Several courts have determined that there were serious deficiencies in the foreclosure process. At a website that I maintain with Tara Twomey, my co-investigator in the Mortgage Study, we make available a list of judicial decisions in which the court finds inappropriate foreclosure practices or misbehavior by mortgage servicers or their agents.⁷ Although we stopped updating the document over a year ago, at that time there were already more than fifty such cases. The problems in such cases range from the imposition and collection of improper fees, a lack of standing to foreclose in judicial foreclosure states, the pursuit of foreclosure without rights in the note and mortgage, mortgage origination fraud, or liability to investors for poor underwriting or improper servicing. The key point is that the vast majority of the alleged problems cannot accurately be described as “technicalities.” The flaws in the foreclosure systems go well beyond improper affidavits.

Mr. Stephan’s deposition on robo-signing was not the first instance of an admission of abuse of the legal process by mortgage servicers and their agents, including their law firms, in the foreclosure process.⁸ To give only one example, exactly two years ago, the U.S. Bankruptcy Court for the Southern District of Florida imposed sanctions on a law firm and a creditor for filing false affidavits to support motions to be permitted to pursue a foreclosure despite a

⁵ Reuters, *Bank of America to Partially Lift Foreclosure Moratorium*, (Oct. 18, 2010) at <http://www.cnbc.com/id/39726850>.

⁶ Jessica Silver-Greenberg et. al., *Banks Restart Foreclosures* (Oct. 19, 2010).

⁷ The Mortgage Study website is at www.mortgagestudy.org. The Resources on Mortgage Servicing document is available at http://www.mortgagestudy.org/files/mortgage_resources.pdf. It should be noted that we stopped updating the document in July 2009. We did so because we were becoming overwhelmed with the number of cases affirming violations of foreclosure practices and servicing duties.

⁸ For example, on September 10, 2010, the Florida Default Law Group filed a motion to withdraw an affidavit in foreclosure case in Palm Beach County, Florida. The motion stated that “[t]he undersigned law firm has recently been notified that the information in the Affidavit may not have been properly verified by the affiant; and accordingly, the Affidavit is hereby withdrawn.” While courts may grant such motions, the withdrawal of the affidavit cannot eliminate the fact that the false affidavit was produced and entered in evidence in a court case. Put more simply, one can admit perjury but that does not negate its occurrence.

debtor's bankruptcy filing.⁹ The lender conceded it had asserted in the affidavit that the debtor owed \$2114 in "penalty interest" that was not owed and estimated that it may have wrongfully charged debtors an identical amount of penalty interest in about 50 other cases. The court imposed sanctions of \$95,000.

Affidavits can be used in several legal contexts. In judicial foreclosure states, they are often filed to support a motion for summary judgment (a victory for the movant (here usually the party filing the foreclosure) without the need for a full trial). Affidavits also are frequently filed in bankruptcy cases of homeowners to support motions asking the bankruptcy court for permission to foreclose on a debtor's home, despite the protection of the bankruptcy stay. Affidavits may also be filed improper fees, a lack of standing to foreclose in judicial foreclosure states, the pursuit of foreclosure without rights in the note and mortgage, mortgage origination fraud, or liability to investors for poor underwriting or improper servicing. Affidavits can also be used when a party has lost the mortgage note,¹⁰ but as described below, the use of a lost note affidavit has important limitations.

The largest and most complex harm that may exist with the loans in default or foreclosure today is that the paperwork for the loans was not transferred correctly. I emphasize that what constitutes a correct transfer is a gray area; we need more direction from courts and legislatures on this subject. But there are plausible legal claims that the transfers of the notes and mortgages were not effective to give the trust full enforcement rights. These issues are complex but to summarize: First, what we commonly call a "mortgage" normally consists to two documents: a note and a mortgage or deed of trust.¹¹ The note creates a debt obligation, the borrower owes the lender a specified number of dollars payable in a specified way. If certain requirements are met, this note may be a negotiable instrument, a term of art under the Uniform Commercial Code. If the note is not a negotiable instrument, it is commercial paper, another term of art. Generally, the law governing notes is Article 3 of the Uniform Commercial Code and general contract law.¹² The mortgage or deed of trust is effectively a grant to the lender of a security interest in the property. Like the note, there are requirements that must be

⁹ *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. Oct. 28, 2008); see also *In re Rivera*, 342 B.R. 435 (Bankr. D. N.J. 2006) (sanctioning law firm \$125,000 for its practice of filing pre-signed "certifications" with the bankruptcy court in support of motions, without such completed certifications being reviewed by the signatory before they were filed by the court.).

¹⁰ See Uniform Commercial Code 3-309.

¹¹ Loans will be secured either by a deed of trust or a mortgage, not both. Either document, if properly completed, creates a security interest in favor of the lender. The reasons for the differences between the two and why one type dominates in a given state are beyond the scope of this testimony, but may in fact have important implications for the legal resolution of paperwork documentation flaws.

¹² Some states have enacted a revision of Article 3 and other states have not, so Article 3 is less than "uniform" at the current time, with states having different versions in effect.

met to create a mortgage (for example, it must be in writing, and in some states, must be notarized). Generally, the law governing mortgages is non-uniform state real estate law, although when mortgages are securitized Article 9 of the Uniform Commercial Code, which is the law in every state, may also be relevant.¹³

The concern being raised is that during the securitization process that the transfers from originator to sponsor to depositor to trust (to generalize the parties in a typical process) were not performed or were not performed correctly. A related issue is whether the physical paperwork or electronic records can be located and are accurate. These records are needed to sort out whether the transfers were completed and valid.

I believe the law is somewhat unsettled on what actually must be done via a securitization to complete the transfers correctly. Some have argued that the traditional processes govern. This would mean the note must be negotiated (if a negotiable instrument) or endorsed (if bearer paper) and that the mortgage must be assigned to each party in the securitization process. The latter issue implicates MERS, the Mortgage Electronic Recording System and whether its efforts to declare itself the nominee for the mortgagee and not make public recordation of the assignments are valid. Others believe that the primary issue is whether the note was transferred correctly, on the theory that the “mortgage follows the note” (but it is not clear whether the same rules applies for a deed of trust). But even here, there is disagreement on whether the transfer of the notes needed to have occurred individually, by endorsement (negotiable instrument) or by transfer of possession (bearer paper), or whether the pooling and servicing agreement somehow suffices to effectuate the transfer of the notes to the trust.

The implications of problems with transfer are serious. If the trust does not have the loan, homeowners may have been making payments to the wrong party. If the trust does not have the note or mortgage, it may not have standing to foreclose or legal authority to negotiate a loan modification. To the extent that these transfers are being completed retroactively, it raises issues about honesty in creating and dating the assignments/transfers and about what parties can do, if anything, if an entity in the securitization chain, such as Lehman Brothers or New Century, is no longer in existence. Moreover, retroactive transfers may violate the terms of the trust, which often prohibit the addition of new assets, or may cause the trust to lose its REMIC status, a favorable treatment under the Internal Revenue Code. Chain of title problems have the potential to expose the banks to investor lawsuits and to hinder their legal authority to foreclose or even to do loss mitigation.

¹³ For example, 9-203(g) and 9-109(a)(3).

For over 10 years, there have been allegations about violations of consumer protection laws and poor/nonexistent underwriting at loan origination. While the law gives great finality to completed foreclosure sales,¹⁴ loans that are currently in default (which some estimate to be as many as 20 percent of mortgages underlying privately-backed securities) are at risk of being challenged for origination violations. These challenges could come in the form of investor suits trying to force banks to buy back loans that did not meet the representations of the securitization documents, e.g., they were not underwritten to the reported standard. Another type of lawsuit risk is that consumers are able to sue the current holder of their note for violations that occurred at origination. Normally, these complaints fail because the holder of the note is thought to be a “holder in due course,” a person that receives protection from most of the claims that someone could bring against the originator of the note. However, if the notes do not meet the requirements of negotiable instruments, there cannot be a holder in due course. The person with the note merely is the possessor “bearer paper,” and can be sued for all wrongs associated with that note contract.

How Serious and Widespread are the Deficiencies in Foreclosures?

The major unanswered question at this time is the extent and severity of any foreclosure deficiencies. Despite the proclamation of James Dimon, President of JP Morgan Chase that no one has been “evicted out a home who shouldn’t have been,” there seems to be near universal agreement that at least some homeowners have lost their homes without adherence to legal procedures, that the validity of many pending foreclosures is in question, and that servicers may face much more extensive examination of their grounds for future foreclosures.

The banks have repeatedly tried to minimize perceptions about the materiality of their foreclosure deficiencies. JP Morgan Chase has tried to narrow the characterization of the allegations, describing them as “process-oriented problems that can be fixed.”¹⁵ The general thrust of the banks’ defense has been that because the homeowners did take on a mortgage obligation, and have in fact missed payments, then the foreclosure is proper. For example, Brian Moynihan, the CEO of Bank of America, said on October 14, shortly before Bank of America reinstate foreclosures in some states, that about a third of the homes Bank of America seizes are vacant, and that borrowers in foreclosed homes typically haven't made payments for 15 to 24 months.¹⁶ Mr. Moynihan’s statement is likely correct; there are thousands of

¹⁴ Posting to *Credit Slips* blog of Robert Lawless, *The Finality of Foreclosure Sales*, Oct. 9, 2010, at <http://www.creditslips.org/creditslips/2010/10/the-finality-of-foreclosure-sales.html>.

¹⁵ Kate Kelly, *JP Morgan: Foreclosure Process Can be Fixed*, CNBC, (Oct. 18, 2010), http://www.cnbc.com/id/39721009/JPMorgan_Foreclosure_Process_Can_Be_Fixed.

¹⁶ Bloomberg, *BoFA Posts \$7.3 Billion Loss on New U.S. Rules* (Oct. 19, 2010).

homeowners in America who cannot pay their mortgages and for whom the foreclosure mitigation options are failing. But Mr. Moynihan's facts are also completely irrelevant to the concerns about foreclosure process. As I have explained recently:

“Just because the homeowner hasn't paid his mortgage doesn't mean anybody in the world can kick him out,” said Katherine Porter, a visiting law professor at Harvard. “The bank has to have the standing to do that.” She added that the bank's argument was a little like saying that someone who committed a crime shouldn't receive a trial because he's so obviously guilty.¹⁷

Due process does not disappear merely upon the assertion by one party that the other is clearly liable. The allegations of problems in mortgage servicing should, if anything, only heighten the due process requirements on consumers. For example, in light of the lack of verification procedures for affidavits to support requests for judgments in judicial foreclosures, it may be reasonable to be concerned that there is absolutely no verification of the facts in the non-judicial foreclosure context. Thus, we might argue that states or the federal government ought to increase the legal requirements for foreclosures across the board, at least for loans initiated in the last five to ten years when widespread allegations of paperwork and procedural problems have existed. The banks' arguments that we can ignore possible systemic wrongdoing by the banks because as a systemic matter, homeowners are in default on their loans, is unpersuasive. Indeed, it seems to reflect a fundamental misunderstanding of the obligations of any party wishing to invoke the aid of the law in enforcing its rights.

The most pressing issue is to assess the extent of the wrongful or problematic foreclosures. This assessment needs to have two fundamental parts. First, how many loans or foreclosures have any defect? Second, what kinds of defects do the troubled loans or foreclosures have? Without an answer to these questions, it is nearly impossible for anyone to do more than speculate about the key questions before this panel about the impact of these troubled loans or foreclosures on the government's foreclosure mitigation efforts and the well-being of financial institutions.

The immediate need is to know the extent to which the problems in mortgage servicing occur sporadically or are endemic. As a preliminary matter, I note that it is simply not credible to believe that the lenders have made no errors in their foreclosure procedure. Because they are being allowed to control the definition of error and are being allowed to audit themselves, we cannot have confidence in such reports. The

¹⁷ Joe Nocera, *Big Problem for Banks: Due Process*, NY Times (Oct. 22, 2010).

question is then is whether the rate of troubled loans is nearly 100% as some have alleged, or rather is a smaller fraction of loans, such as 5%.

Regardless of the size of the problem, lenders have an obligation to address it and to comply with legal rules. But the ways in which a lender may need to address the problem, and the responses to the problem from regulators and markets, will change depending on whether the problems are sporadic or endemic. It may be, for example, that there are entire pools of loans that were improperly documented and serviced; other pools may be entirely clean. In such a situation, issues concerning the authority of the trust to act despite its passive structure and the ability to do wholesale loan modifications under the pooling and servicing agreement should be front and center. On the other hand, if the problems occur with less frequency but are spread throughout the mortgage market, the solution may be individualized approaches that leave resolution to the courts or mediators.

The other key question is to determine what kinds of problems exist with the loans. Robo-signing is a relatively easy matter to fix, at least in theory, although the culture of servicing practices may cause compliance to erode again in the future. Problems with chain of title, on other hand, are quite complex. Fixing these problems requires grappling with legal issues that are uncertain and complex. For example, what is the legal effect of an assignment in blank of a mortgage? Most scholars think this is an invalid document that cannot serve as a conveyance of real estate. How should that conclusion be harmonized with case law that emphasizes that the “mortgage follows the note,” suggesting that it is ownership of the note, not the mortgage that is crucial for transfer? How does the revision of Uniform Commercial Code Article 9 affect this analysis? To take another example, if a trust cannot show a proper transfer of the note and mortgage, can it mediate with the homeowner to reach an agreement that the homeowner will agree to release liability on these issues in return for a loan modification? The answer seems to be “no,” on the grounds that only the party with title to the property and with the right to enforce the note has the authority to alter its interest in the property. Put more simply, two parties that do not have good title (the trust via its servicer agent and the homeowner) probably cannot confer good title on the trust by agreement among themselves. Doing so would inhibit the rights of the non-present party and may leave an unenforceable agreement that clouds title for years to come.

The Panel asked in its written invitation to me that I address the question of whether I believe the problems with foreclosures processes and loan paperwork are endemic in the industry. I have no definitive evidence to support my answer to that question. Indeed, as I say above, I think it is lack of knowledge of how widespread the problems may be that is turning the allegations into a crisis. Lack of knowledge feeds speculation and worst case scenarios. It

also permits implausible denials of responsibility and a lack of accountability. None of these reactions are going to aid the housing market in its recovery or assist homeowners in keeping their homes. At best, they are causing uncertainty and delay, which I do not see as providing a net overall benefit, even from the consumer/homeowner perspective. The Congressional Oversight Panel should urge regulators and financial institutions to immediately outline a plan for auditing a sample of loans at each servicer, including analysis of loans that were part of private mortgage-backed securities as well as GSE or FHA loans, as the type and extent of problems may vary by class of loans.

I do think that the structure of the mortgage servicing industry and the lack of accountability by financial institutions in the securitization process make it a fair inference that the problems from flawed foreclosure are not isolated incidents. The robo-signing scandal should not have been a surprise to anyone; these problems were being raised in litigation for years now. Similarly, I released a study in 2007—three years ago—that showed that mortgage companies who filed claims to be paid in bankruptcy cases of homeowners did not attach a copy of the note to 40% of their claims.¹⁸ This behavior occurred in the face of court supervision of the bankruptcy process, review of the claims by a bankruptcy trustee, the debtor in nearly all instances having obtained a lawyer to represent her interests, and a clear rule requiring a copy of the note to be attached. My study does not prove, and could not prove with the data that I used, whether the mortgage companies have a copy of the note and refused to produce it to stymie the consumers' rights or to cut costs, whether the mortgage companies or their predecessors in a securitization lost the note, or whether someone other than the mortgage company is the holder/bearer of the note. The depth of the problem—more than four in ten loans—provides some support for concerns expressed by consumer advocates that the deficiencies in paperwork and inappropriate foreclosure processes are widespread and systematic. In addition, as I discuss in my study, mortgage servicing is a high-volume industry. Its personnel have relatively little training, weak supervision, and are under pressure to cut costs and boost profits. These structural qualities of mortgage servicing make it likely that procedural problems need to be treated as part of a pattern or practice of illegal behavior and not as isolated incidents.

Finally, I want to share with the Panel that the lawyers that I have met over years of my research on mortgage servicing—both creditor lawyers and debtor lawyers—have nearly universally expressed that they believe a very large number (perhaps virtually all) securitized loans made in the boom period in the mid-2000s contain serious paperwork flaws, did not meet underwriting or other requirements of the trust, and have not been serviced properly as to default and foreclosure. I trust and respect these individuals; they are in the trenches,

¹⁸ Katherine M. Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 121(2008).

reviewing paperwork and litigating these cases. I trust and respect the courts around the country that have devoted time and resources to identifying such problems and preparing published opinions to explain the legal consequences of such problems. In the wake of these parties' longstanding allegations and findings of inappropriate and illegal practices, I am unable to give weight to recent statements by banks such as Bank of America that only 10 to 25 of the first several hundred loans that it has reviewed have problems.¹⁹ As Professor Adam Levitin has noted, what exactly does this mean?²⁰ Are there 10 problem loans or 25 problem loans? What is the nature of the problems? And, most crucially, how is a problem being defined? Given statements by industry that suggest their interpretation of "problem" is limited to outright lying to a court (which the announcement of the moratoriums seems to have acknowledged was an actual problem that needed remedying) or taking the house of someone who has made all their payments, industry numbers of the scope of the problem should be given no weight. The need for outside audit and verification of loans and foreclosure procedures remains urgent.

Responses to Flawed Foreclosures

Litigation: The defects in foreclosure and the servicing errors suggest two possible types of lawsuits that banks are likely to face. Each type of lawsuit has the potential to expose the nation's largest banks, because they own servicing arms, to serious risk of damages or injunctive relief. Without legislative that retroactively changes the law for foreclosures for mortgages made in the past, it is difficult for the government to discourage or prevent homeowners or investors from exercising their rights through litigation.

Most obviously, homeowners can contest the right of a plaintiff to foreclose. The homeowner may allege that the foreclosure paperwork is incorrect (e.g., invalid affidavit), or that the foreclosing party is not entitled to enforce the mortgage or note (e.g., they lack title to the mortgage or are neither the holder nor bearer of the note), or that the servicer has bloated its fees and charges beyond what is legally permitted (e.g., force-placed insurance applied inappropriately.) Each of these lawsuits would require a certain amount of discovery, such as depositions or document production, to resolve. In addition, absent settlement by the bank, the court would have to hold an evidentiary hearing to determine whether the homeowners' challenge to the foreclosure should prevail. Each of these processes will take time, increasing the loss severities on the foreclosure. FBR Capital Markets estimated that direct litigation costs for cases filed by homeowners could reach \$4 billion, while the delay in foreclosure in such contested cases could add an additional \$6 billion in costs. While it is also important to consider the substantial burden on the court system to resolve such matters on a case-by-case basis, the

¹⁹ Dan Fitzpatrick, *BofA Finds Foreclosure Document Errors*, Wall Street Journal, Oct. 24, 2010.

²⁰ Posting to *Credit Slips* blog by Adam J. Levitin, *Faulty Foreclosures*, Oct. 25, 2010, at <http://www.creditslips.org/creditslips/2010/10/faulty-foreclosures.html>.

costs to the bank of litigating with each homeowner may encourage servicers to be more willing and generous to modify loans. In this way, the foreclosure process crisis may actually improve loss mitigation outcomes.

Any such effect, however, will be tempered by the fact that it is very difficult as a procedural matter for homeowners in non-judicial states (where the filing of a lawsuit is not required to foreclose) to get their claims of foreclosure wrongdoing before a court. In general, to do so, a homeowner would have to file for a temporary restraining order; procedurally this is like making the homeowner the plaintiff, in terms of filing fees and the burden to go forward on the evidence and arguments. For many consumers, the lack of a judicial forum in a non-judicial state will mean that no official decision-maker will be involved in resolving the alleged wrongdoings.

The extensive media coverage of the moratoriums, combined with the confirmed regulatory response by the states Attorney Generals, will almost certainly embolden more homeowners to challenge their foreclosure. At the margin, the belief that they might win in litigation could diminish a homeowners' pursuit of a HAMP loan modification. My own view, however, is that most homeowners would prefer to avoid the stress of a court case and receive a loan modification, and that we will largely see homeowners using the foreclosure wrongdoing as a shield when the homeowner is in foreclosure.

The second type of lawsuit that seems certain to follow the exposure of the flawed foreclosure procedure is a claim by investors that problems at loan origination, including a lack of paperwork to support a valid foreclosure, or mortgage servicing mishaps have increased their losses. These suits most obviously will seek to force the banks to "buy back" or "repurchase" loans that were improperly placed into a particular trust for securitization or were improperly originated. Investors could also argue for money damages for lost revenue stream or breach of fiduciary duty by the trust or the servicer to exercise good judgment in favor of investors' interests. These suits could be incredibly expensive for banks, requiring the payments of large claims to make investors whole and to satisfy the plaintiffs' attorneys who will bring such cases.

Regulation: At present, the servicers face new regulations or enforcement actions to require compliance with the applicable law. The most aggressive, and seemingly well-coordinated, response to date is from the 50 states' Attorney Generals. This makes sense as several Attorneys General formed an organization called the State Foreclosure Prevention Working Group back in early 2008 or 2007.²¹ The Attorneys General have expertise in mortgage

²¹ Press Release, Office of Martha Coakley, *Multi-state Foreclosure Prevent Group Release Third Report* (Sept. 29, 2008),

servicing. Also the Dodd-Frank Financial Reform Bill clarified that the Attorneys General have the power to enforce federal consumer laws and repealed some Supreme Court precedent that held that state authorities were preempted from bringing actions against national financial institutions. I expect the Attorneys General to be aggressive; they are elected officials and the public's tolerance for financial institutions making sloppy or socially-harmful decisions seems very low. The most likely outcome from such a lawsuit is that the Attorneys General gain concessions from servicers about their willingness to do mediation before foreclosure or to relax their rules about who may receive a loan modification.

The federal regulatory landscape is unsettled. While the Consumer Financial Protection Bureau may have jurisdiction to regulate to address many of the homeowners' concerns, it is patently obvious that the Bureau remains too understaffed and too engaged in its set-up functions to tackle the allegations of foreclosure wrongdoing in a major way. I do think, however, that the Bureau could begin its function of consumer financial education by offering videos or printed material to help homeowners understand the current situation with regard to foreclosure defects. This type of educational outreach is relatively simple to put into place, and importantly has a large pay off for the Bureau in terms of being seen as visible and "on the job" during the fallout from the foreclosure moratorium—the first big event since its creation.

The Treasury and HUD have both made announcements about their responses to the allegations of wrongdoing. Mr. Donovan has announced that HUD began a review of the five largest mortgage companies it deals with on government-backed securities through the Federal Home Administration. Importantly, the worst problems are likely to be in private-label securitizations, rather than government-backed bond offerings. Thus, it may be hard to generalize from HUD's finding to the worst hit segment of the housing market. It appears that the HUD review is primarily focused on keeping borrowers in their homes or transitioning homeowners out of ownership. While this may produce evidence of widespread servicer disparity in efforts at foreclosure mitigation and may help police servicers' commitments under the HAMP program, this focus is unlikely to provide any measure of the depth of the most serious problem in the flawed foreclosure laundry list, which is lack of title and the difficulties in obtaining proper transfers.

It is unclear if the Treasury is pursuing an independent investigation, although Deputy Secretary Michael Barr has answered questions about the wrongful behavior of the servicers. Arguably, however, his comments reflect a continued mindset that the banks and servicers could and just should fix procedures, and that it "is not a problem for Secretary Donovan to

fix.”²² The difficulty with this statement is that it reflects a continued trust in the banks and servicers to self-correct and self-police. Yet, in light of both the allegation of poor procedural adherence and limited authority to deviate from standards, the public’s confidence in allowing banks and servicers to check their own misbehavior is extremely (and perhaps understandably) low.

A transparent government response that assessed the veracity of the allegations of wrongdoing would be reassuring to the housing market and the capital markets. Until the government does so, the specter of such action will create a drag on the housing markets and the financial institutions’ well-being. Without the launch of such a research project, I fear that people will conclude that their government is not positioned to know the depth of the problems with foreclosure procedures.

Housing Markets: The problems with foreclosures—both whatever they actually are and what they are perceived to be—are having a deleterious effect on the recovery of the housing market. While the slowdown in foreclosure may provide a short-term benefit to homeowners, it does not offer a permanent solution. It may, in some instances, be offering false hope to homeowners who may assume that their loan or foreclosure is flawed and that they will be able to stay in their houses, perhaps without having to make any payments or with all prior defaults forgiven. Homeowners who have such beliefs may be less committed to pursuing loan modifications. They may also be overwhelming strained housing counselors, legal aid offices, and courts with requests to raise paperwork or foreclosure process arguments. Those helping homeowners on the front line cannot afford to ignore such requests given the likelihood that problems are systemic and do affect many of their clients loans. But piece-meal litigation of such issues will be expensive, and I am deeply concerned about the knowledge capacity of existing organizations to address these complex legal claims, particularly on the issues about proper assignment.

On the other hand, it is true that the negative press and litigation and regulation risks may be increasing the industries’ willingness to modify loans. But such an outcome is positive only if we are confident that the loan modifications being made are sustainable and that they are not continuing to mask paperwork defects that must ultimately be addressed. The negative press and litigation and regulation risks are undoubtedly deterring some people from purchasing foreclosed homes. If such concerns are not abated, the banks that are resuming foreclosures may ultimately end up with increased REO stock that must be addressed.

²² Shahien Nasiripour, *Obama Team on Furor Over Foreclosures: ‘Problem for Banks and Servicer to Fix’* (Oct. 20, 2010) at http://www.mass.gov/?pageID=cagopressrelease&L=1&LO=Home&sid=Cago&b=pressrelease&f=2008_09_29_foreclosure_report&csid=Cago,

Finally, the housing market faces a grave risk of near complete shutdown if the concerns about correct transfer of loans should cause title insurers to refuse to write new policies on foreclosed homes. This would leave banks saddled with REO properties and would not permit the housing market to find its bottom by processing the pending foreclosures and returning the properties to the market.

Conclusion

For at least three years (and probably closer to five years), there have been well-publicized and repeated allegations that mortgage servicers, trusts, and others in the securitization process have engaged in misbehavior or committed mistakes. The concerns about shortcomings in documentation, procedure, and substantive rights are not new. In fact, the current “crisis” has existed for years, as homeowners’ and investors’ rights have been ignored in the foreclosure process. It is very likely that there are thousands, and possibly hundreds of thousands, of families who already have lost their homes were deprived of procedural or substantive rights.

But America does not have to continue in a “crisis.” We do not have to tolerate abuse of the legal system, systematic errors, bloated fees, and chaos in the housing and financial sector. As a society, we have the tools to guard against wrongful foreclosure going forward. These tools include legal reforms and regulatory intervention. The fixes are not simple or cheap fixes, but they are possible. The banks and servicing industry designed and implemented the practices that allow inaccurate and unfair foreclosure procedures to flourish, and it is entirely right that they should have to shoulder the cost, in both time and money, of designing and implementing improved procedures.

Permitting the current situation to continue threatens to undermine the fragile recovery in the financial sector and to further erode the weakness in the housing market. The key task going forward is to provide transparent measures of the depth of deficient paperwork and to provide reliable monitoring of foreclosure processes. Without additional information and reassurance, prospective homebuyers and prospective investors in financial institutions are likely to be reluctant to join together in rebuilding the damage of the housing economy created by the failure of foreclosure mitigation.