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The Long-Awaited Nationwide Mortgage Settlement: Only a Small Step Forward in the Struggle for Accountability in the Financial Crisis

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I. BACKGROUND

After sixteen months of negotiation, state attorneys general and the federal government have reached agreement on a record joint state-federal settlement with the country's five largest lenders—Ally Financial (formerly GMAC), Bank of America, Citigroup, J.P. Morgan Chase, and Wells Fargo—over improper foreclosure practices. The nationwide accord seeks to address banks' misconduct that took place after the burst of the housing bubble. A federal investigation in 2010 discovered widespread abuse of foreclosure practices.¹ Some of the largest lenders in the country that process foreclosures issued improper mortgages, violated homeowners' rights and protections, and used false affidavits. Bank employees did not properly verify documents: They signed papers they had not read or forged signatures to expedite foreclosing on homeowners. These behaviors constitute the so-called "robo-signing" practice.²

Announced in February, the settlement was filed in D.C. Federal Court on March 12, 2012,³ and was approved by a federal judge on April,

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1. PHILIP A. LEHMAN, NORTH CAROLINA DEPARTMENT OF JUSTICE, EXECUTIVE SUMMARY OF MULTISTATE/FEDERAL SETTLEMENT OF FORECLOSURE MISCONDUCT CLAIMS (2012) [hereinafter EXEC. SUMMARY].

2. Peter A. Holland, *The One Hundred Billion Dollar Problem in Small Claims Court: Robo-Signing and Lack of Proof in Debt Buyer Cases*, 6 J. BUS. & TECH. L. 259, 268 (2011).

3. See *\$25 Billion Mortgage Servicing Agreement Filed in Federal Court*, U.S. DEP'T OF JUST.

5, 2012.⁴ The deal consists of \$25 billion in relief to distressed borrowers as well as direct payments to states and the federal government.⁵ While this is the largest multistate settlement since the Tobacco Settlement in 1998 and the largest consumer financial protection arrangement in U.S. history,⁶ one question remains: is this settlement a comprehensive solution to the current foreclosure crisis?

II. BREAKING DOWN THE MORTGAGE SETTLEMENT: HOW FAR DOES \$25 BILLION GO?

Under the settlement, \$1.5 billion is to be distributed nationwide among roughly 750,000 borrowers whose homes were sold or foreclosed between January 1, 2008 and December 31, 2011.⁷ The following highlights several terms of the settlement. First, eligible homeowners will be entitled to receive a cash payment of approximately \$1500 to \$2000 without a requirement to prove financial harm and without having to release private claims against the servicers.⁸ Second, the deal also provides \$17 billion in principal reduction and loan modifications for homeowners who are both underwater and behind on their mortgages.⁹ Third, homeowners that are current on their mortgages but underwater will be able to refinance their current loans at lower rates.¹⁰ A total of \$3 billion of the settlement is to be set aside for this purpose. Lastly, the remaining funds of \$3.5 billion will go to state and federal governments for the purpose of repaying public funds lost as a result of servicers' misconduct.¹¹ The funds will also be used to provide legal aid and housing counselors, among other public programs.¹² The program is designed to last for three years, but includes incentives for banks to provide relief within the first year so that the aid can get to homeowners sooner rather than later.¹³

(Mar. 12, 2012), <http://www.justice.gov/opa/pr/2012/March/12-asg-306.html>.

4. See *National Mortgage Settlement*, U.S. DEP'T OF JUST. (May 3, 2012, 4:15 PM), http://www.justice.gov/ust/eo/public_affairs/consumer_info/nms/.

5. EXEC. SUMMARY, *supra* note 1.

6. *Id.*

7. NATIONAL MORTGAGE SETTLEMENT, FACT SHEET: MORTGAGE SERVICING SETTLEMENT (2012).

8. See generally *Federal Government & Attorneys General Reach Landmark Settlement with Major Banks*, NATIONAL MORTGAGE SETTLEMENT, <http://www.nationalmortgagesettlement.com> (last visited Aug. 15, 2012).

9. *Id.*

10. *Id.*

11. *Id.*

12. In response to the subprime crisis, consumer protection has been considered one of the top priorities of the Federal Government. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the Consumer Financial Protection Bureau. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1021 (2010). Among the objectives of the Consumer Financial Protection Bureau is to ensure that "consumers are provided with timely and understandable information to make responsible decisions about financial transactions."

12 U.S.C. § 5511(b)(1) (2012).

13. MORTGAGE SERVICING SETTLEMENT, *supra* note 7.

III. THE BRIGHT SIDE OF THE DEAL

It is positive that during the negotiation process both the attorneys general and the federal government have kept in mind that foreclosures provoke a wide range of negative consequences.¹⁴ Foreclosures not only cause personal strife for families that are thrown out of their homes, but foreclosures also have terrible effects for the economy at large.¹⁵ Consequently, under the agreement, new mandatory servicing standards are to be implemented in order to make foreclosure a last resort. The standards require servicers to evaluate homeowners for alternative loss mitigation options first before considering foreclosure.¹⁶ A consideration for a loan modification can impede servicers from foreclosing. The new measures also include procedures for reviewing loan modification applications and grant homeowners the right to appeal rejection.¹⁷

A second positive side of the deal is that it leaves the door open for future litigation, despite the banks' efforts to shield themselves from further investigations and prosecutions.¹⁸ The settlement allows for the possibility of future legal actions based on fair-housing and fair-lending laws, civil rights claims, claims dealing with securitization, and possible criminal penalties. Moreover, the settlement neither impedes individuals from joining class-action lawsuits nor does it impede lawsuits that private investors can file for damages. Essentially, the banks are not immune from being punished for other wrongdoings. This landmark settlement has marked a beginning rather than an end of what is to come for banks.

IV. CRITIQUES OF THE DEAL

First, the deal falls short of compensating people that were illegally evicted from their homes. The reason is that the deal applies solely to borrowers who were illegally and wrongfully foreclosed upon between September 2008 and the end of 2011. While these borrowers will be entitled to receive checks of around \$1500 to \$2000 if they sign up, the deal overlooks those who have already been thrown out of their homes.¹⁹ In this particular aspect, the deal falls very short in terms of compensating the people that were illegally thrown out of their homes.

The number of distressed homeowners who can be eligible is further narrowed because the settlement applies only to loans held on the books

14. EXEC. SUMMARY, *supra* note 1, at 1. To understand how foreclosures can impact communities, see Immergluck Dan & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUSING POL'Y DEBATE 57, 58-60 (2006).

15. FED. RES. BOARD, THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 20 (2012).

16. EXEC. SUMMARY, *supra* note 1, at 3.

17. *Id.*

18. *Id.* at 4.

19. NATIONAL MORTGAGE SETTLEMENT, *supra* note 8.

of the five banks that agreed to settle. Hence, only the borrowers who hold a mortgage issued by one of the banks' signatories to the agreement will be able to benefit from the settlement.²⁰ This leaves out all the homeowners with mortgages held by Government Sponsored Enterprises Fannie Mae and Freddie Mac,²¹ which means to exclude approximately half of the nation's mortgages.²²

A third criticism is that the banks remain in control of the programs they offer to their customers. The deal requires the banks to create independent internal review groups to track their own compliance with the terms of the settlement. These internal groups report periodically to an external monitor. It seems that this hybrid system of internal and external monitoring basically allows the banks to police themselves.²³ One consequence of this self-policing mechanism is that the amount of reduction of a homeowner's mortgage principal depends on the servicer who owns the loan.²⁴ This can be unfair to some people because different lenders can treat two loans with similar features differently.

Fourth, the deal addresses only a very limited set of fraudulent behaviors and does not include the worst practices carried out by the lenders regarding securitization.²⁵ However, as noted above, banks are still exposed to future legal complaints with regard to fraudulent and unlawful practices other than robo-signing.

Fifth, the amount of money to be paid by the banks has neither a deterrent nor a punitive effect. A careful look at the settlement's breakdown reveals that the actual total cash paid out by the banks is only \$5 billion dollars, split among the five signatory banks.²⁶ In effect, this is really a soft penalty, especially considering the billions of U.S. dollars that

20. *Id.*

21. See Mary Ellen Podmolik, *Robo-Signing Deal Could Be Filed in Court Friday*, CHI. TRIB. (Mar. 9, 2012), http://articles.chicagotribune.com/2012-03-09/business/ct-biz-0309-robo-20120309_1_robo-signing-servicing-and-foreclosure-practices-principal-reductions.

22. DEBORAH LUCAS & DAVID TORREGROSA, CONG. BUDGET OFFICE. FANNIE MAE, FREDDIE MAC, AND THE FEDERAL ROLE IN THE SECONDARY MORTGAGE MARKET (Dec. 2010).

23. See Kate Berry, *Consumer Groups Praise Banks' Big Role in Monitoring Mortgage Deal Compliance*, AM. BANKER (Mar. 16, 2012), http://www.americanbanker.com/issues/177_52/Joseph-Smith-consumer-advocates-national-mortgage-settlement-1047567-1.html.

24. Julie Schmit, *Some Struggling Homeowners More Equal than Others*, USA TODAY (Mar. 19, 2012, 10:11 AM), <http://www.usatoday.com/money/economy/housing/story/2012-03-15/Mortgage-foreclosure-settlement/53615668/1>.

25. See, e.g., Leslie Wayne, *Calpers Sues over Ratings of Securities*, N.Y. TIMES, July 15, 2009, at B1.

26. See Consent Judgments, *United States v. Bank of Am. Corp.*, No. 12-0361 (D.D.C. Apr. 4, 2012), available at https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_Ally-4-11-12.pdf, https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_BoA-4-11-12.pdf, https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_Citibank-4-11-12.pdf, https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_Chase-4-11-12.pdf, and https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_WellsFargo-4-11-12.pdf.

were paid in bonuses during past years.²⁷

Sixth, enforcing compliance can be difficult. Before the mortgage settlement was announced, fourteen of the largest servicers in the country were attempting to comply with federal consent orders from the Office of the Comptroller of the Currency, and the five signatories to the deal were included among these servicers.²⁸ The terms of the deal overlap to some extent with these existing consent orders, which could complicate banks' compliance aims with both, as well as the role of the external settlement monitor.²⁹ In any case, the consequences of the overlapping would not be terrible if one keeps in mind that both the consent orders and the deal share a common objective; they are "complimentary."³⁰ In case of doubt, banks should comply with the one in which the standard is higher.³¹

Seventh, certain requirements set forth by the deal merely forbid conduct that has already been illegal. An important part of the deal is its role in consumer protection through the implementation of "new" foreclosure standards.³² From now on, banks seeking to foreclose are required to submit sworn affidavits including the legal right of the servicer to proceed and the precise amounts owed.³³ Bank officers who sign the affidavits are now mandated to actually peruse the documents that they swear to have perused already.³⁴ This serves only to discourage an unlawful practice that had previously been forbidden by law.³⁵

A final critique of the deal is that the banks receive benefits at the expense of certain investors who are not parties to the deal. The deal affects the position of mortgage-backed securities (MBS) investors despite the fact that these investors never agreed to the settlement. As previously noted, the settlement offers banks incentives to write down not only the principal of loans they own themselves, but also to write down loans held in securitized trusts.³⁶ This means that banks are going

27. See e.g., Andrew M. Cuomo, *No Rhyme or Reason: The 'Heads I Win, Tails You Lose' Bank Bonus Culture*, N. Y. State Office of the Att'y Gen. (July 30, 2009) <http://www.ag.ny.gov/sites/default/files/pressreleases/archived/Bonus%20Report%20Final%207.30.09.pdf> (revealing that Citigroup paid out \$5.33 billion in bonuses, Bank of America paid out \$3.3 billion in bonuses, J.P. Morgan Case & Co. paid out \$8.69 billion in bonuses, and Wells Fargo paid out just under \$1 billion in bonuses).

28. See Kate Berry, *Mortgage-Deal Overlap with OCC Orders Complicates Oversight*, AM. BANKER (Mar. 19, 2012) http://www.americanbanker.com/issues/177_53/OCC-consent-orders-national-mortgage-settlement-1047593-1.html.

29. *Id.*

30. *Id.*

31. *Id.*

32. EXEC. SUMMARY, *supra* note 1, at 3.

33. *Id.*

34. *Id.*

35. See Michael Hiltzik, *Mortgage Settlement Is Great—For Politicians and Banks*, L.A. Times (Feb. 11, 2012), <http://articles.latimes.com/2012/feb/11/business/la-fi-hiltzik-20120212>.

36. See Kate Berry, *MBS Investors Cry Foul Over National Mortgage Settlement*, AM. BANKER (Mar. 20, 2012), http://www.americanbanker.com/issues/177_54/mortgage-servicer-settlement-securities-principal-writedowns-1047665-1.html.

to receive cash for refinancing loans they do not even own because the loans belong to investors in mortgage backed securities.³⁷ It does not seem fair that these investors suffer the loss from the reduced principal while the servicers receive “credits” for doing them, especially if the investors were not responsible for the abuses that led to the banks’ settlement with federal and state authorities. Sometimes the public equate these MBS investors to Wall Street executives but that view is not strictly correct. In reality, many of those who heavily invested in MBS before the meltdown were institutional investors,³⁸ such as pension funds, retirement systems or universities. These investors were required to invest in AAA-rated debt and bought plenty of these new financial products.³⁹ Therefore, losses to mortgage investors translate to losses to consumers such as the elderly whose pension funds have been depleted.

CONCLUSION

Evaluating the settlement as a whole, one realizes that, indeed, the truth has not been brought to light and that an explanation is still lacking for what really happened during the financial crisis, why it happened, and who is accountable for the disaster.⁴⁰ Despite all the investigations, it seems that the culprits were not held responsible, that justice has not been served, and that wrongdoers did not pay for their misdeeds. Also, it would be fair to say that the punishment has not been proportional to the crime so far, and therefore it is not likely to deter similar behaviors in the future.

If we expected a punitive deal that brings accountability and a comprehensive solution, this is not the settlement we were looking for. But at least it provides some relief to a group of distressed homeowners; thus, it is better than nothing. Although this settlement is a step forward in the right direction without a doubt, there is a lot more that needs to be done. Banks must be held accountable, as well as other agents that played important roles in the subprime crises, such as the credit rating agencies and the regulators. Irresponsible borrowers who asked for loans that they could not afford should also bear a portion of the blame and should not be able to benefit from this settlement. What is clear is that it will take a while before confidence in the financial system and the government will return.

37. *Id.*

38. Arnold Kling, *The Financial Crisis: Moral Failure or Cognitive Failure*, 33 HARV. J. L. & PUB. POL’Y 507, 511 (2010).

39. Xavier Gabaix et al., *Limits of Arbitrage: Theory and Evidence from the Mortgage-Backed Securities Market*, 62 J. OF FIN. 557, 562 (2007); Viral V. Acharya & Matthew Richardson, *Causes of the Financial Crisis*, 21 CRITICAL REV.: J. POL. & SOC’Y 195, 199 (2009).

40. See, e.g., David Skeel, *Mortgage Settlement or Mortgage Shakedown?*, WALL ST. J., Feb. 21, 2012, at A19.

Finally, it is worth highlighting that in his State of the Union Address President Obama recently announced the creation of a new unit that would expand investigations into the abusive lending practices and the packaging of risky mortgages leading up to the housing crisis.⁴¹ Commenting on the settlement, the President stated that “we’re going to keep at it until we hold those who broke the law fully accountable.”⁴² Let us wait and see if these proposed measures are enough to ensure that the law is enforced and justice is served.

41. *Remarks by the President in State of the Union Address*, THE WHITE HOUSE (Jan. 24, 2012, 9:10 PM), <http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address>.

42. *Remarks by the President on the Housing Settlement*, THE WHITE HOUSE (Feb. 9, 2012, 12:28 PM), <http://www.whitehouse.gov/photos-and-video/video/2012/02/09/president-obama-speaks-landmark-housing-settlement-banks#transcript>.

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