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Mortgage Securitization 401: Household, Bank, and Investor Exposure surrounding disputes.

Symphony Music

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(This material was prepared by a mortgage securitization geek but simplified to make it straightforward for smart people to understand. This material should be exciting for those who want to discover why the financial banking system no longer works. Mortgage securitization is about nuance. To understand what drives the actions of banks, and sometimes why regulators are missing the picture, many finer nuances of mortgage securitization must be understood. This Memorandum is an attempt to identify common structural realities and the implication for business associated with those realities).

Overview Preamble:
There are multiple variations to the described process of securitization. The particularities of each segmented tranche of a securitization are only limited by the imagination and risk bearing appetite of investors. The underlying concepts mix “bank,” “finance,” “insurance,” “investment” and “local real estate registration” operating concepts, all that must be understood to capture an understanding of the whole.

While acknowledging that the securitization process has continuously evolved since the early 1980s, this memorandum purports to identify themes that remain constant, in one form or another, and how mortgage loan defaults affect the situation.

Like with other words, this report recognizes that the banking industry has, over time, changed the meaning of words. As examples, within specific functions, the banking industry has exempted itself from recognizing the traditional definition of the word “dispute,” or even such simple concepts as “doing business.”

This report recognizes that most households, politicians, and State judges are neither well-informed about where actions and disputes “start and end” nor about the nationally chartered banks complete responsibility for the current state of financial affairs, something they prefer to deny. The banking industry has successfully circumvented many known regulatory restrictions so the question this creates is whether they have gone too far and whether they may have broken the public trust.

This report identifies numerous independent frauds that banks involved in securitization have imposed on consumers. The fraud is perpetrated in defiance of the public trust that grants organizations their banking charters. It additionally completely circumvents insurance regulations via the self-serving statement that no “insurance” is involved. This report estimates the cost paid by certain consumers of the consequence of the fraud.

The following topics are covered:

- **Part I** What actually happens in a mortgage securitization?

- **Part II** Tranche “A,” “B” and “C” exposures when the Servicer does not convince the borrower to find a substitute lender:
  (Includes overview of regulatory issues)

- **Part III** In foreclosure, what issues does Securitization raise?

- **Part IV** Dilemmas & Conclusion.

- **Appendix:** The moral wrong.
Part I  What actually happens in a mortgage securitization?
i) Before a securitization happens, Step 1:
Someone originates 200 mortgage loans for 200 customers in one State.

For simplicity, imagine:
200 Households borrow $500,000 each = a $100,000,000 package of loans to be securitized.

For continued simplicity, let us assume all loans are originated on the same day and agree to pay “interest only” for five years at 5.875%. This means the Households agree to pay $5,875,000 in interest every year to the owner of the promissory notes for five years. After five years, the interest rate is re-set according to an agreed to formula. The Households plan their “loans” with the organization they consider “their bank.”

ii) Step 2:
Whoever originated the loans sells the package of 100 promissory notes to a Special Purpose Vehicle in exchange for $100,000,000 plus “more.” The Special Purpose Vehicle knows it will get “more” because it knows that investors will pay extra for different rights that exist in the package. These rights can involve many things but the simplest rights are those that involve different priorities to the cashflow collected by the Special Purpose Vehicle.

For example, three investors will negotiate for three sets of privileges:
Tranche A: Invests $70,000,000 at what seems to be 4.00%, and agrees for one set of rights
Tranche B: Invests $20,000,000 at what seems to be 7.50%, and agrees to another set of rights
Tranche C: Invests $14,000,000 at what seems to be 10.00%, and agrees to still another set of rights.

The purchased rights most often involve priority to monthly collected cashflow.

To continue with the simplified example, to make the above numbers work, we assume that the total amount of cash collected from the Tranche investors is $104,000,000. The investment bankers and organizing originators are paid $4,000,000 in fees by the Tranche investors who are introduced to the investment opportunity. In this simple example, the Servicer receives $175,000 annually to collect and monitor the payments of 200 individual monthly events. This fee is a large amount of money to pay for the salary of one individual to monitor compliance, most of which is paid electronically. Servicer employee teams generally handle many more than 200–loans-per-individual. To the casual observer, from the outside, the securitization is refinancing itself at what seems to be a cost of 5.649% per year, a savings of 0.226%.

Said another way, the combined amount of money the Tranche investors pay for the privilege of receiving the $5,875,000 annually is $104,000,000 (i.e. $4,000,000 more than the principal amount actually owed by Households). Each Tranche investor, via an investment agreement, negotiates for different rights. These rights most often involve the priority associated with the redistribution of the cashflow collected for the Special Purpose Vehicle via the Servicer.

iii) Elaboration in slightly greater detail… By negotiating to prioritize the receipt and redistribution of the cash-flow into different tranches, the investor groups give
themselves the impression of assuring themselves greater certainty about the flow of cash they receive at specific points in time. This certainty is worth money to some investors.

In the example, Tranche A, who puts up 70% of the cash required by the securitization, is happy to receive an effective cash yield of 4% in exchange for being paid the first 70% of all cash received by the Servicer. The Tranche A investor has bought more “timing certainty,” something that is very important to some investors. These Tranche A investors also get comfort from the fact that if an underlying portfolio does not perform as initially anticipated, they calculate and operate under the assumption that either the investors in Tranche B or C will buy them out of their Tranche A exposure.

Tranche B & C, who put up the balance of the required cash required by the securitization, do so because they are attracted by the high effective yield they seem to be receiving assuming that all the mortgage instruments continue to pay “on time, when due.” Tranche B & C see themselves as receiving yields of 7.5% and 10% from mortgage instruments that have all agreed to pay 5.875%. They view themselves as receiving 27% and 70% “more” than what the homeowners are actually paying in yield. Tranche B & C accept the proposition that they are not as concerned about the timing of the receipt of the cash they anticipate receiving. As long as loan-to-value or government insurance remains in force, the Tranche B & C investors will earn their return through final adjustments during “an accounting” following a foreclosure.

Tranche B & C perceive themselves as receiving more cash yield for what they think is the same amount of principal credit risk as the investors who receive 4%.

This perception is correct as long as underlying mortgages continue to pay “on time, when due” and as long as residential real estate prices are stable or rise.

iii) Where the problem starts...

No matter what the cause, a different scenario develops when payments stop being collected by the Servicer “on time, when due.” A different scenario also develops when home prices drop or when insurance is not in place.

Tranches A, B & C do not own the Promissory Notes. Nor does the Servicer.

The Promissory Notes to any securitized package are owned by the Special Purpose Vehicle. That Special Purpose Vehicle is not permitted to disclose individual names and addresses of portfolio asset holdings for privacy reasons. Granular disclosure by the Special Purpose Vehicle to the investors in Tranche A, B and C is not permitted because of privacy concerns associated with random “investors” buying control of individual loans of targeted celebrities or persons of interest.

As such, when a cash flow shortfall occurs to Tranche C or Tranche B, Tranche C & B are completely relying on the ability of the Servicer to somehow persuade the non-performing underlying asset to perform, or to act in a manner that somehow substitutes themselves out of their obligation to the Special Purpose Vehicle. Despite whatever the Servicer says, the Servicer's power of persuasion is not backed up by any ownership to the Promissory Note.
In actuality, the Servicer “pretends” to accommodate the Household by providing “loan modification” or by somehow persuading the borrower to get themselves refinanced by a government loan program. In actuality, if approved, "loan modification" just adds missed payments as a bullet obligation onto the mortgage loan amount at maturity. It is only offered because servicers are incentivised to offer these for the receipt of new fee income.

The owner of the Promissory Note is usually a trust authorized to only carry out ministerial tasks as defined in their founding agreements. The Servicer is a “servant,” tasked not to take decisions, but to carry out specific functions. Without specific approval from the owner of the Promissory Note, something that would require him to execute more than ministerial tasks, it is difficult to understand how the Servicer ever receives authority to do anything except what it is tasked to do as a robot. The Servicer and the trust (aka the Special Purpose Vehicle) are not hired to think. Neither has the authority to approve or finalize a loan modification. Acceptance of the loan modification would generally require the trust to think, a task that is more than ministerial and much more similar to the role of a “thinking” banker, but they are doing this thinking as an accredited sophisticate investor and not as a profession licensed by any regulatory authority to interact with consumers. This difference is stark.

Whatever the case, the Servicer does not own the loan so the bank is not facing any imminent loss. The spirit of loan modification works only because some investors seem to have agreed to it for whatever unknown reason. Public discussion on the issue suggests that Households and politicians do not understand how the “banking system” has juggled most considerations into their favor so that the banking system only comes out ahead.

Under all conditions, “loan modifications” actually provide only superficial relief to all parties that accept its terms. The process does not disclose the new fees being paid to the Servicer. The Process doesn’t recognize the higher interest costs Promissory Note payers may already have paid to investor groups for long periods while Servicers collected lucrative monthly fees. Most importantly, the process does not recognize that it is the Servicer’s parent, the regulated “Bank,” that has imposed an expensive cost on Households by no longer providing competitively priced mortgage loans to Households, let alone to its existing customers. The banks say it represents “market forces” but, in reality, it only represents the market force of their decision.

The securitization process is such that the Servicer has no motivation to listen or to actually work with a “serviced” client. The Servicer fully realizes that its relationship with the borrower is only that of a fee-for-service vendor. Contrary to the spirit of the Servicer's compact with the State that granted the Servicer its charter to operate, the Servicer is not concerned about the effect of its activities on a client.

The process of securitization breaks the bank’s initial relationship with the client. The process of securitization breaks the client’s relationship with a publicly spirited chartered “benevolent & regulated banker” trying to work with his clients within the State economy where the banker is authorized to operate.

The government loan programs that are developed with the help of a Servicer’s regulated
parent, the “Bank,” are created so that new principals substitute themselves as investors in underlying mortgages. Taxpayers subsidize government loan programs. The government programs agree to lend the borrower the amount of money that somehow makes the Tranche B, C, and A investors whole. The government sponsors reason that they do not want Households to become homeless. Households will not disagree. The current interest rate environment is such that these government loan programs do this at low fixed interest rates. The government programs do not disclose to taxpayers that their government loan programs only subsidize investor groups who are already benefiting from the high yields and high fees that they received, and continue to receive.

v) The Consequences of Asset Substitution…(aka “loan modification”)
The process of replacing a Promissory Note in a Special Purpose Vehicle’s pool with the proceeds from a government loan program is an “asset substitution.” The Servicer is ambivalent about asset substitution. The Servicer is disappointed at no longer receiving his servicing fees and those other fees to which he thinks he may be entitled from that Household, but he accepts this reality.

The Tranche B & C investors are also disappointed at no longer receiving their higher effective yields. Nevertheless, the Tranche B and C investors are pleased that the process of substitution keeps their perceived principal whole with no "principal" loss. Tranche B & C investors are happy that they received a higher yield while things were going as intended. They just received the higher yield for a shorter period. Unless they are not insured and the home value dropped below the principal amount of the loan, they will also have not incurred any losses. The Tranche B & C investors collect all monies due to them through the date of a final auction sale through the final accounting adjustments.

Some banks are themselves investors in the high yielding Tranche C investor groups, but for accounting purposes, only when they accept “on balance sheet” treatment, an issue of concern to banks as they report to regulators and shareholders.

Part II Tranche “A,” “B” and “C” exposures when the Servicer does not convince the borrower to find a substitute lender:

i) The Initial Reality…
The Servicer does not own the Promissory Note. The Tranche A, B and C investors also do not own the Promissory Note.

The Tranche C investors have the highest risk exposure to the securitization. As an investor exposed with a $14,000,000 investment in the securitization, when cashflow yields are identified as “lower,” the only option for the Tranche C investor group is to buy the balance of the securitized portfolio for the $90,000,000 of cash it did not originally advance. If interest rates dropped, then the Tranche C investor has to pay more than $90,000,000 to buy out the Tranche A investor. Whatever the exact amount, this purchase is the only way for the Tranche C investor to perfect its claim on the Promissory Note and the mortgage encumbrance.

This investment is expensive. For the initial privacy reasons that prevent granular disclosure, the decision to purchase can only be based on superficial statistical summaries
that the Special Purpose Vehicle was originally permitted to release as part of its ministerial duties. This information is limited in value. Even if the information were excellent, it may not be within the capacity of the unidentified Tranche C investor's financial capabilities to raise the $90,000,000 to buy control. It may not be within the Tranche B’s capabilities either.

There is little that Tranche C or B investors can do to enforce rights they may otherwise think they have without taking over the complete deal. The Promissory Note is continuously owned by the Special Purpose Vehicle. The Special Purpose Vehicle’s sole task is to accept and redistribute whatever cash the Servicer collects on their behalf. The Servicer doesn’t want it and never receives title to a Promissory Note in order to effectuate a foreclosure. (*This reality can be confirmed with access to the Tranche investors’ underlying investment agreements associated with any defaulting Promissory Note. Under all conditions, part of the successful lawsuits against servicers and their robo-signing endeavors confirm this reality.*)

The Tranche A investors, by the way, remain content with the Servicer's performance as long as at least 70% of the 200 original loans continue to perform as originally intended.

If this does not happen, the Tranche A investors have to advance and purchase the Tranche B & C positions for some amount between $30,000,000 and $34,000,000. It is after making this new investment, when Tranche A investors own the Promissory Notes, that they, in theory, are permitted to foreclose on the properties that have not performed according to their original intentions. But it is not so simple.

The accredited tranche investors are not regulated banks permitted to interact with non-accredited bank customers. They actually need to conduct their activities through a bank. But the Servicer is only a fee-for-service vendor with very limited responsibilities. The “bank” is the organization that owns the “Servicer.” As further explained below, the bank has to somehow receive funds from the Tranche investors to somehow become the owner of the offending Promissory Note before it can initiate more than “moral persuasion” enforcement procedures.

**ii) The Special Purpose Vehicle…**

The owner of the Special Purpose Vehicle generally controls all agreements and instructions given to the Servicer. That owner is not easily identified. It is meant to just be a passive pass-thru organization with no substance; a trust, only carrying on ministerial tasks. Its instruction to others, however, suddenly make it more than ministerial, especially when a Household has a material dispute with his originating bank or his Servicer. Even if it was a “retained right” negotiated by the originating bank prior to its sale of a Promissory Note to a Special Purpose Vehicle, it is the owner of the Special Purpose Vehicle that effectively pays its Servicer from a “yield spread.” Under three separate “investment agreements” that owner of the Special Purpose Vehicle also engages itself to share cashflow as it arrives. The Special Purpose Vehicle owner, no matter how finely the English language is sliced to make a situation half pregnant, effectively tells the Servicer to collect monthly cashflows and to immediately begin foreclosure procedures in the event of a missed payment.
As a descriptive base line, it is the Special Purpose Vehicle that tells the Servicer that he will provide the Servicer with an “offending” Promissory Note to start a foreclosure. In the normal course of operations, on behalf of Tranche A, B and C investors, the Special Purpose Vehicle asks the Originator or the Servicer to substitute out any offending Promissory Note with money or substitute mortgage loans. Such a request requires performance by the Servicer, who requests help from the Tranche A, B and C investors or the banks that are involved. Someone has to provide cash or “substitute” mortgage loans that become a replacement for offending Promissory Notes. Everything can work smoothly in an environment where there is no dispute between the bank and the Household as to the amounts due.

In an environment where Households dispute anything, the Special Purpose Vehicle and the investor expose themselves to liability. The liability includes the consequences of asking the Servicer to execute a fraud on Households who may raise the dispute, towards bank regulators for entering the regulated banking business by a back door, plus more. The bank’s role as accomplice in allowing Tranche investors to enter into the banking business via a back door can be envisioned as the initially unidentified accredited Tranche investor interacting with non-accredited Households, or by their non-compliance with Federal laws including the Community Reinvestment Act. The Special Purpose Vehicle enters into the unfortunate position of having to state to a judge that they are one type of entity, either “a bank” or “not a bank,” that they provide only ministerial services, or not, each position which dominoes into disclosure and liability problems for other participants.

As a twist of detail, it is unlikely that the Special Purpose Vehicle owner ever receives the right to disclose the ownership of the offending Promissory Note without breaching either: 1) his privacy non-disclosure duty to the Household, or; 2) his responsibility to the Tranche A investor. The Special Purpose Vehicle is anticipating that either the Servicer, or the bank, or the Tranche B or C investor, will provide that substitute collateral they expect. After “asking” for the substitution, a “responsibility” the servicer takes on with gusto, the Special Purpose Vehicle’s owner’s obligations to do anything without the delivery of substitute collateral is unclear. The Tranche A investors, however, will not allow the Promissory Note to be delivered to anyone unless they are substituted by collateral of equal or better quality with the same cashflow coverage amounts and yield. The Special Purpose Vehicle owners can tell the investors in Tranche B or C that they have an obligation to purchase or substitute “x” amount of collateral with “y” cash flow yields within a specified time frame. The Special Purpose Vehicle owner states that it is prepared to provide an offending Promissory Note to any third party but it can effectively only provide the Promissory Note to a regulated bank. As stated earlier, the bank therefore has to receive a loan or investment from the Tranche C investor for the specific purpose of substituting assets with the Special Purpose Vehicle and initiating foreclosure action on a Household.

Without disclosure to bank regulators or to the SEC or the banks’ accountants, it is difficult to imagine how this is done without triggering issues with each party or without having committed a fraud.
The Foreclosure Sale…

At the final foreclosure, depending on perceived valuations, the bank that is permitted to interact with the Household, will compete with its desires to collect its servicing fee and the separate interests of the Tranche A, B and C investors. The priority of these claims is only known to the involved parties via the individually tailored investment agreements and the original terms of sale between the originating bank and the Special Purpose Vehicle. These have all evolved uniquely over time.

At the stage of a foreclosure auction or sale, however, the bank and the Tranche investors will have already had to have provided the cash or substitute collateral and to have received ownership in the offending Promissory Note. A statement to a State judge about the “contingent future receipt of title” and the bank’s characterization about the sincerity of any loan discussion with a Household otherwise seems tenuous. A judge’s decision, however, remains solely his.

Tranche A investors will compete against the Household and the other Tranche investors for ownership of title to the property. Assuming perfect organization, the Household receives the opportunity to bid for the Promissory Note that encumbers his property for 70%, 80%, and 100% of the principal amount plus accrued interest. All proceeds above the amounts due to the lenders go back to the Household. The Household has a chance of coming out ahead as long as the bank’s excess charges are successfully contested and as long as the Household receives access to new money.

Special Note…

The process of securitization does not fundamentally care whether the cashflow is generated by 100 Promissory Notes with a principal balance of $1,000,000 each or 400 Promissory Notes with a principal balance of $250,000 each. The process of securitization also does not care how many tranches are created. It is the cashflow that counts and the manner in which the few known characteristics of the underlying properties can be statistically parsed. From the example under consideration, all the above interest yields can be adjusted to any of many combinations of interest rates between 3.00% and 31.75%. The organizing premium paid to organizing groups and servicing fees can vary widely. Nothing is set as everything is negotiated by accredited investors who are very aware of the terms.

The changing meaning of Words…

The US and individual States have adopted many laws and regulations that influence how individuals, businesses, and the Courts interact with each other. These laws are based on words. Examples of sensitive words include “dispute,” “lender,” “hardship,” F/K/A (“formerly known as”), “insurance,” and the concept of “transacting business.” From a skeptical homeowner’s point of view, whether or not a homeowner is in “dispute” with his lender, his lender will not use the word “dispute” because it means he may be obligated to report the fact that there is a dispute to the credit bureaus. This has its own consequences. Likewise, regulated “banks” with whom the consumer initially interacted have morphed themselves into “lenders,” “servicers,” “investors,” and “mortgage creditors,” seemingly all for the sake of avoiding interaction with a primary regulator. “Hardship” is currently only the homeowner’s “hardship” and, when discussing with bankers, is never the “hardship” caused by the bank’s actions, or its non-compliance with State and Federal laws and the compacts associated with the receipt of their banking charters. “F/K/A” has become a
convenient way for title companies to attempt to retroactively correct incorrectly filed mortgage liens by somehow presenting legitimacy to assignments filed out of State. This is just strange. “Insurance” is a term that is avoided because it scares originators to contemplate that they may be subject to State insurance regulation and reporting. “Transacting business” is an activity distinct from “doing business” as the former is often a corporate activity exempt from State registration; it helps obfuscate the interaction between a Servicer and a homeowner so that the Servicer’s personnel do not become liable for State payroll or income taxes that would otherwise be due for conducting the business of “debt collection” in any particular State.

vi) Who Regulates this activity in any particular State? A case study…
No one. As an example, in the State of Connecticut, there is no State regulatory authority that influences or supervises the business/retail interaction of activities between a bank and the homeowner once the Promissory Note is securitized.

In Connecticut, servicers are typically banks chartered by the Office of the Comptroller of the Currency (“OCC”). Local State banking departments defer to OCC’s examination of State based nationally chartered banks. For whatever reason, the nationally chartered banks, and their debt issuance and debt collection activities, are also typically exempt from State requirements that otherwise require a State issued “certificate of authority” before conducting business in a State. The business activities of Special Purpose Vehicles and the investors who invest in securitized tranches of the pool of mortgages bundled with the homeowner’s Promissory Note are therefore not supervised by anyone. They are not supervised by exemptions granted in State registration requirements because of the business they are in and/or because they hired an OCC supervised bank to act as their front for their interaction with homeowners.

In the end, a homeowner who initially borrows from a regulated bank and has his promissory note securitized, finds himself negotiating with a sophisticated investor without anyone supervising or taking responsibility for the Special Purpose Vehicles’ and Tranche investors’ interaction with that homeowner. This end-result is strange.

It is very convenient to the accredited investor, the servicer, and the Special Purpose Vehicle that owns the homeowner’s Promissory Note, that no State based regulatory organization has the authority to influence that interaction between a local non-accredited homeowner and an accredited sophisticated out-of-State investor.

The Insurance Issue: As stated above, the securitization of residential mortgages involves the bundling of, for example, 200 individually underwritten situations involving Promissory Notes and mortgage liens with assets located in, for example, one State. This bundle is sold in exchange for cash to a Special Purpose Vehicle. The Special Purpose Vehicle, involving only assets from one State - although not necessarily headquartered in that State - engages itself to receive cash from that State’s households via the actions of a bank regulated Servicer. The Special Purpose Vehicle divides the cash it receives into separate tranches, or priorities, based on an investment agreement with a sophisticated accredited investor. The Servicer often states that it is the investor.

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This process of dividing cash flow received from many people into different priorities, in my opinion, is a form of insurance. The highest priority tranche investor benefits from the fact that the lower priority tranche investors agree to delay the receipt of their cash in the event of a non-payment by a household. The “insurable interest” is that investor’s desire for the certainty of the cash flow. There is no transfer of ownership of the assets (the Promissory Notes and the mortgage liens) to the investor. The assets involve only assets that are originated in one State and, in the event of non-payment by a household, cause interaction between a tranche investor (who has not received any insurance license) and a household. The cash payments made to the Special Purpose Vehicle convert themselves from “interest & principal” payments into “premium” payments because of the manner in which the Special Purpose Vehicle pools the cash and prioritizes its outflow. The premium payment becomes a premium taxable event at that point when the cash payment is made by the household who, in theory, is benefiting from the insured product’s better interest rate that the lender makes available. This procedure is organized/facilitated by the originating lender to avoid premium taxes, insurance reporting, and insurance registration requirements associated with the insurance process.

vii) A Case Study: The Unanswered Question around a big dispute…

Washington Mutual was “combined” with JPMorgan Chase on September 25, 2008. With the acquisition of Washington Mutual, Chase’s franchise became oligopolistic and no national “savings” bank was left to serve the Connecticut area. Chase was also a recipient of Federal taxpayer supported loans in 2008. Chase’s Federal support gave Chase access to liquidity at a low cost of funds.

For Households, shortly before the reluctant “combination” of the two banks, the best interest rate was around 5.875%. Starting in November 2008, interest rates dropped precipitously.

Despite its access to low cost funds, for whatever reason, Chase decided to not allow existing customers to benefit from lower refinancing rates requiring all who would not qualify under newly created, but arbitrarily selected, underwriting standards, pay interest rates above those paid by Chase’s preferred customers.

Chase achieved its profit driven objective partially by altering their underwriting standards in their favor and by influencing the base Index standard on which new loans began to be priced. They reinforced this by operationally shifting Households’ relationships from that with a bank with Community Reinvestment Act and other obligations to one with a fee-for-service vendor representing unidentified accredited non-bank regulated investors. These efforts, combined and as individual events, together with the complex motivations that drove the interaction with Households and their securitized loans, made it such that certain customers paid much more while keeping everyone confused about events. Chase added pain to the formula by undermining the valuation opinions of professional licensed appraisers and substituting Chase’s arbitrary opinions based on algorithmic formula that necessarily revert to a lower average value from which new loans could be considered.

Chase states that Washington Mutual’s underwriting standards were never Chase’s standards. Chase states its behavior is the result of market conditions. Both statements
are not true. Chase has stated that it purchased Washington Mutual originated mortgages. The market conditions to which Chase refers are of Chase’s own creation.

Despite the existence of strict laws against anti-competitive behavior and non-predatory lending, Chase used its oligopolistic market position to collect excess fees from large classes of borrowers for extended periods. Bank regulators have not reacted to this.

Available data suggests that the amount of excess interest received by Chase between November 2008 and October 2011 is $3,700,000,000 nationwide. It is higher if other assumptions are used.

Will Chase be required to reimburse all those customers? How will the courts, the bank regulators, the SEC, and the accountants treat Chase?

Chase has repeatedly stated that it has a strong record of compliance with securities law despite the fact that it has made six settlements for securities fraud in 13 years including one where it paid $228 million to settle civil and criminal charges that it cheated public servants in cities and towns by rigging bids. One of the wrongs that Chase imposes on Connecticut mortgage loan consumers is the same as the one for which it paid its fine.

Chase is being pursued by Attorney Generals from multiple States and by at least one racketeering lawsuit in Florida.

Part III In foreclosure, what issues does Securitization raise?

A) Are politicians aware that their government loan programs are actually taking Tranche B and C investors out of an exposure Tranche B and C investors were originally eager to accept? Government loan programs effectively double up on rewards to Tranche B and C investors: first, by the higher yield that they collect and, second, by the creation of a government loan program that substitutes their exposure with taxpayer capital.

B) Did the banks notify regulators about how they shifted their mortgage customer relationship away from one with a regulated bank to one with an unnamed Special Purpose Vehicle and unnamed and unregulated accredited investors? Are the regulators aware of the significance of the shift? Standard consumers are all of a sudden negotiating with random accredited investors with no regulatory oversight.

C) Will a State judge agree that the priority of the beneficiaries of Federal Agency bailouts should be the bank, its paid management, its shareholders, and then the consumers? Or was it the banks’ obligation to address earlier the consumers’ stress at paying high interest rates?

D) Did banks that originated loans record a liability to continue to provide mortgage loans at competitive interest rates to its clients as interest rates dropped?
   a. If already fully exposed, as banks say they are, are the banks just permitted to enforce their high interest rate collections, or should banks have made new loans available at re-set interest rates plus a standard processing fee (The way it used to be done before 2008)? How long are Households meant to wait before the subsidized loan savings from which
banks benefited get shared with the banks clients? When do predatory lending law restrictions come into play?

b. Does the receipt of a bank charter include a public trust to serve all segments of a local community? When underlying economic factors change, are banks simply allowed to invent excuses that “simply” allow them to create new underwriting rules that conveniently allow them to collect high interest rates from classes of clients forever?

c. Was keeping all interest rates fixed the correct thing to have done the minute after a bank accepted taxpayer subsidized advances from any taxpayer funded Federal agency? OR should banks have figured out how to pass on the benefits they received onto their consumers of credit?

d. Are banks who act as servicers permitted to make statements about ownership that they must know are false ab initio, i.e.

   i. To initiate Notices of Acceleration that they know are based on false statements of ownership?

   ii. To hire third party notice providers under false pretences?

   iii. To hire third party service providers to trespass on private property under false pretences?

   iv. To notify national credit bureaus when nothing is actually due to them (The bank is only a servicer, they own nothing). Isn’t it only the Special Purpose Vehicle who owns the note who is allowed to notify a national credit bureau of any late payment, after it ascertains there is no dispute?

   v. To ignore complaints, disputes, or demands for restitution just because they interpret some documents and its stated obligation in only a self-serving manner?

   vi. To not disclose new fees they earn by providing loan modifications? (Where is their requirement to comply with the spirit of disclosure as required by HUD and its Settlement Statements?)

   vii. To badger unsophisticated consumers into accepting “modification” of any sort without explaining the full consequences to the borrower.

E) Did banks create a liability to the SEC and their reporting requirements by:

a. Not acknowledging a responsibility for all their originated and securitized loans as they, the banking industry and each individual bank, remain proportionally the only parties permitted to interact directly with Households?

b. Not acknowledging that foreclosure actions by their Servicers required each bank to “buy” ownership of non-paying loans before they could be permitted to initiate foreclosure action?

c. Not acknowledging the amount of their excess charge reimbursement liability to Households by keeping large classes of borrowers locked into high rates?

d. Not disclosing the changing nature of their legal liability exposure by disclosing the Attorney General lawsuits and the racketeering lawsuits being filed against them regarding their home lending practices?
e. Not disclosing their involvement in the regulated insurance business by both participating in the creation of an insurance product (the Tranche A “investment agreement”), not reporting the existence of the insured product by complying with insurance licensing and reporting requirements, not paying the associated premium taxes, and selling insurance without a license?

F) Did the banks disclose to the relevant State banking regulators and State Court systems how they shifted their internal obligation for customer dispute resolution to State legal systems with no discussion as to who should bear the cost?

G) In all discussions, do banks have an obligation to disclose that they are only acting as a fee-for-service vendor and are not acting as a principal and owner of a Promissory Note while interacting with Households?

H) Do banks have the obligation to disclose that they are motivated to maintain the status quo for as long as possible for multiple reasons, contrary to the interests of the Homeowners?

I) Are the duties of the Special Purpose Vehicle more than ministerial once they start directing foreclosure activity and procedure? Does this jeopardize their tax status?

J) Is the Index that is used to determine the banks’ loan cost-of-funds an arm’s length measure or a second profit center for their lending activities?

K) Do the banks’ internal secret residential real estate valuation systems that necessarily undervalue property values via a reversion to an average need to be transparent to customers and brokers? Or are banks allowed to rely on these arbitrary numbers in an uncontested manner to lower the amount of financing they make available to Households?

**Part IV Dilemmas & Conclusion:**

If the Special Purpose Vehicle declares itself an unlicensed “bank,” who should have been regulating them? More importantly, into whose balance sheet should their activities be reported or consolidated? Who has not thought through the chain of events associated with foreclosure on a securitized Promissory Note? Who has not reported the activity to any individual State’s insurance department? Who has not reported this item on their audited balance sheet and to the SEC?

If the Special Purpose Vehicle declares itself a disinterested simple pass thru, why is it giving instructions as if it were an entity with its own corporate purpose? Is the Special Purpose Vehicle passing judgment by not acknowledging or letting itself become aware of the existence of a dispute? Does the blind application of procedure meet the intended purpose associated with why that procedure was required? Is the Special Purpose Vehicle’s posture exposing its tax status to liability?

The intricacies of residential mortgage securitization surrounding disputes raises multiple breaches of fiduciary, privacy, insurance, and bank regulatory issues that can seemingly only be resolved by the originating bank substituting new capital into any individually securitized transaction before being able to actually foreclose. This is expensive and is unlikely to happen. This reality therefore highlights the disingenuous empathy of
Servicers to their alleged clients’ situations. Servicers, despite public trust, do not care. This reality and process immediately raises liability and fraud issues involving historic accounting, tax, SEC and insurance reporting.

Ugly, ugly.

Securitization causes banks behavior to change. The effect of this change for the period starting in September 2008 through today manifests itself as higher interest costs to the consumer and higher State legal cost in terms of dispute resolution. The inevitable conclusion about the driving force behind the identified behavior change is that banks have forgotten to give priority to the public trust and responsibility associated with operating as a bank in any given State.

Solution for the Banking System, a Personal Opinion: Since admitting misrepresentation is terrible, the reality becomes that the involved banks are no longer just “too big to fail,” they’ve worked themselves into the dilemma of being “too big to function.” This is a “material event” and must be evident to bank management. Banks therefore need to keep consumer mortgage interests cost high to force these consumers, as best they can, to substitute themselves away from the bank’s responsibility and liability. This purpose is the very opposite of the one associated with the public trust of receiving a region’s banking charter. Under current circumstances, the banks are only motivated to provide loan modification, only blaming the homeowner, never their own actions, for the difficulty they cause as a non-present lender. Loan modification resources, however, are limited. It is therefore only a matter of time before the large banks are broken up into their separate State or regional banking entities.

Federal and State bank regulators will unfortunately most likely not promote change. Bank regulators will all be persuaded by the larger banks that change is not a good idea. Bank regulators will not be attuned to the fact that it is “character” that drives the first of the five “C’s” of credit decisions and that banks need to be organized to provide working capital and low mortgage interest costs to the business building “characters” in their local communities. No economic community has ever developed or “recovered” without access to credit. For similar reasoning as to why railroad regulators did not encourage the development of the airline industry, Bank Regulators will not capture the urgency of implementing rule changes that delivers working capital to their service territories. Outstanding mortgage Promissory Notes of those individuals who cannot benefit from existing lower cost bank programs will all need to renegotiate their interest rates on a case-by-case basis and attempt to recapture the overpayments they may have already made to their bank, often by disintermediating away from the banking system. No other solution seems to exist.

Appendix. The Moral Issue: Why are the nationally chartered banks wrong?
The banks that are nationally chartered and allowed to operate in any single State operate in an environment that does not promote a sustainable economic development environment for that State. By not providing working capital, and by not having reduced the cost of loans to their borrowers when their own cost of funds dropped to zero, such banks ignored the trust with which they were burdened and therefore missed their moral
obligation to make the total economic system in which they operate do so in a long term sustainable manner. Nationally chartered banks manipulated – and continue to manipulate - their financial environment to prey on customers to pay themselves excess monies based on the convenience of their overbearing market influence in most States.

As an example, Chase bought Washington Mutual. When mortgage rates dropped, Chase refused to re-set the interest rate on existing loans, for whatever reason, because Chase did not want to. Despite the fact that Chase was benefiting from taxpayer funded lower costs, Chase provided its customers no other option and no other option existed in most of the regions served by Chase.

For whatever reason, Chase decided it was good for it to collect as much money from State residents as possible. Chase did not reinvest its deposits in low profit mortgages to State residents, or other activities that benefited State businesses.

Chase stopped funding certain middle market companies. Via its support of short selling activities, Chase continued to fund organizations and individuals that strove to break up businesses that were building product and employment.

Although certain past actions by Chase are understandable, surrounding mortgages, Chase became morally wrong as soon as it accepted TARP funds that changed the underlying nature of all previous agreements. Not recognizing this moral error is further error.

The nationally chartered banks are technically wrong.

A public trust is associated with receiving a banking charter to operate in any State. Through their actions, however, the nationally chartered banks only gave themselves priority. The nationally chartered banks do not prioritize the financial interests of the residents and local business community they are primarily meant to serve.

In the event of a disagreement, the nationally chartered banks have organized themselves to disregard existing law by immediately initiating legal procedural action before even talking with their customer. The nationally chartered banks no longer know the character of their customers and, anyway, have removed all decision for local character question away from local managers. As an example, when a dispute occurs, Chase simply organizes internal and external agents to harass and intimidate residents with telephone calls and written statements that conflict with each other and which, taken together, cannot all be true. In the event of mortgage payment disputes, Chase accompanies its legal action through robot generated Form letters, outsourced foreign country telephone notification information collection procedures, and internal communication that breach domestic and international privacy law.

Everyday, nationally chartered banks take assets they “own,” but that are also “owned” by homeowners, and use it as collateral to borrow funds without compensating homeowners for the financial benefits they only keep for themselves. For some, this unjust compensation is similar to farming a landowner’s land and not paying the landowner any rent.
The nationally chartered banks’ business organization is wrong. As a business operation, the banks are wrong to rely on the separate existence of a legal court structure system as the sole manner to resolve their otherwise internal business/client service disputes. Without disclosure to clients or to the State in which they operate, the nationally chartered banks have outsourced what is traditionally an internal resolution dispute service to any individual State’s legal process system. This policy burdens State residents and the State with costs.

Furthermore, the banks actually do not “own” the assets some of their personnel often mischaracterize as assets they own. The banks actually have little to no “skin in the game.” This lack of alignment brings to the forefront the moral hazards associated with catering to conflicting objectives. This conflict results in bad decisions, exemplified by bad economic decisions, that stem from the uncoordinated actions of separate bank units acting in their own self-interest but not realizing that they must coordinate. Providing banking services or working capital loans to private equity funds who sell common stock “short,” or create the equivalent in the non-public market, is wrong. Bank underwriting policy that blinds itself to character issues of how money is expended is wrong, especially when the loan to a non-bank chartered organization circumvents restrictions that are otherwise placed on the lending bank. With respect to benefiting financially from “short sales,” current bank practice by nationally chartered banks accelerates wealth destruction to the detriment of the otherwise very difficult process of sustainable wealth building that brings social and economic stability to a State.

Increased “market power” captured in a regulated environment comes only with increased responsibility to cater and serve the public trust. The public trust associated with the acceptance of a bank charter involves serving the known needs of a local State economy and its residents. This includes the responsibility to make working capital and long term mortgage loans available at competitive interest costs to the businesses and residents of the State where they are permitted to operate. Not doing so, and not providing the transparency to State regulators to verify adherence to this principle is wrong. Conduct measured against US antitrust and fair competition laws, or against prudent man rules as they would apply in any State economy as understood by individuals who have to make a whole State economy work, is important to the well-being of all involved.

The good news for the nationally chartered banks: They may be technically correct. If only reviewed from a narrow document interpretation point of view, homeowners may be required to pay banks the high interest costs on monies that were loaned to them during a time when all the underwriting rules and interest costs were very different. These homeowners may be required to pay even higher interest costs when their mortgage loan interest rates are re-set. Nevertheless, to enforce this self-serving policy interpretation in judicial states, servicers – on behalf of their clients that own the loans - will have to have not made any errors in their processing. Both parties will also have had to remain compliant with local State law and all existing and past real estate registration rules.