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# Fraud in Home Mortgages: "ForeclosureGate" and Obama's "Pocket Veto"

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Global Research, October 08, 2010
Web of Debt 7 October 2010

Region: USA
Theme: Global Economy, Poverty & Social Inequality

Amid a snowballing foreclosure fraud crisis, President Obama today blocked legislation that critics say could have made it more difficult for homeowners to challenge foreclosure proceedings against them.

The bill, titled The Interstate Recognition of Notarizations Act of 2009, passed the Senate with unanimous consent and with no scrutiny by the DC media. In a maneuver known as a "pocket veto," President Obama indirectly vetoed the legislation by declining to sign the bill passed by Congress while legislators are on recess.

The swift passage and the President's subsequent veto of this bill come on the heels of an announcement that Wall Street banks are voluntarily suspending foreclosure proceedings in 23 states.

By most reports, it would appear that the voluntary suspension of foreclosures is underway to review simple, careless procedural errors. Errors which the conscientious banks are hastening to correct. Even Gretchen Morgenson in the New York Times characterizes the problem as "flawed paperwork."

But those errors go far deeper than mere sloppiness. They are concealing a massive fraud.

They cannot be corrected with legitimate paperwork, and that was the reason the servicers had to hire "foreclosure mills" to fabricate the documents.

These errors involve perjury and forgery — fabricating documents that never existed and swearing to the accuracy of facts not known.

Karl Denninger at MarketTicker is calling it "Foreclosuregate."

Diana Ollick of CNBC calls it "the RoboSigning Scandal." On Monday, Ollick reported rumors that the government is planning a 90-day foreclosure moratorium to deal with the problem.

Three large mortgage issuers – JPMorgan Chase, Bank of America and GMAC — have voluntarily suspended thousands of foreclosures, and a number of calls have been made for investigations.

Ohio Attorney General Richard Cordray announced on Wednesday that he is filing suit against Ally Financial and GMAC for civil penalties up to $25,000 per violation for fraud in hundreds of foreclosure suits.

These problems cannot be swept under the rug as mere technicalities. They go to the heart of the securitization process itself. The snowball has just started to roll.

**You Can't Recover What Doesn't Exist**

Yves Smith of Naked Capitalism has uncovered a price list from a company called DocX that specializes in "document recovery solutions." DocX is the technology platform used by Lender Processing Services to manage a national network of foreclosure mills. The price list includes such things as "Create Missing Intervening Assignment," $35; "Cure Defective Assignment," $12.95; "Recreate Entire Collateral File," $95. Notes Smith:

[C]reating . . . means fabricating documents out of whole cloth, and look at the extent of the offerings. The collateral file is ALL the documents the trustee (or the custodian as an agent of the trustee) needs to have pursuant to its obligations under the pooling and servicing agreement on behalf of the mortgage backed security holder. This means most importantly the original of the note (the borrower IOU), copies of the mortgage (the lien on the property), the securitization agreement, and title insurance.

How do you recreate the original note if you don't have it? And all for a flat fee, regardless of the particular facts or the supposed difficulty of digging them up.

All of the mortgages in question were "securitized" – turned into Mortgage Backed Securities (MBS) and sold off to investors. MBS are typically pooled through a type of "special purpose vehicle" called a Real Estate Mortgage Investment Conduit or "REMIC", which has strict requirements defined under the U.S. Internal Revenue Code (the Tax Reform Act of 1986). The REMIC holds the mortgages in trust and issues securities representing an undivided interest in them.

Denninger explains that mortgages are pooled into REMIC Trusts as a tax avoidance measure, and that to qualify, the properties must be properly conveyed to the trustee of the REMIC in the year the MBS is set up, with all the paperwork necessary to show a complete chain of title. For some reason, however, that was not done; and there is no legitimate way to create those conveyances now, because the time limit allowed under the Tax Code has passed.

The question is, why weren't they done properly in the first place? Was it just haste and sloppiness as alleged? Or was there some reason that these mortgages could NOT be assigned when the MBS were formed?

Denninger argues that it would not have been difficult to do it right from the beginning. His theory is that documents were "lost" to avoid an audit, which would have revealed to investors that they had been sold a bill of goods — a package of toxic subprime loans very prone to default.

**The Tranche Problem**

Here is another possible explanation, constructed from an illuminating CNBC clip dated June 29, 2007. In it, Steve Liesman describes how Wall Street turned bundles of subprime mortgages into triple-A investments, using the device called "tranches." It's easier to follow if you watch the clip (here), but this is an excerpt:

How do you create a subprime derivative? . . . You take a bunch of mortgages . . . and put them into one big thing. We call it a Mortgage Backed Security. Say it's $50 million worth. . . . Now you take a bunch of these Mortgage Backed Securities and you put them into one very big thing. The one thing about all these guys here [in the one very big thing] is that they're all subprime borrowers, their credit is bad or there's something about them that doesn't make it prime. . . .

Watch, we're going to make some triple A paper out of this. . . Now we have a $1 billion vehicle here. We're going to slice it up into five different pieces. Call them tranches. The key is, they're not divided by "Jane's is here" and "Joe's is here." Jane is actually in all five pieces here. Because what we're doing is, the BBB tranche, they're going to take the first losses for whoever is in the pool, all the way up to about 8% of the losses. What we're saying is, you've got losses in the thing, I'm going to take them and in return you're going to pay me a relatively high interest rate. . . . All the way up to triple A, where 24% of the losses are below that. Twenty-four percent have to go bad before they see any losses. Here's the magic as far as Wall Street's concerned. We have taken subprime paper and created GE quality paper out of it. We have a triple A tranche here.

The top tranche is triple A because it includes the mortgages that did NOT default; but no one could know which those were until the defaults occurred, when the defaulting mortgages got assigned to the lower tranches and foreclosure went forward. That could explain why the mortgages could not be assigned to the proper group of investors immediately: the homes only fell into their designated tranches when they went into default. The clever designers of these vehicles tried to have it both ways by conveying the properties to an electronic dummy conduit called MERS (an acronym for Mortgage Electronic Registration Systems), which would hold them in the meantime. MERS would then assign them to the proper tranche as the defaults occurred. But the rating agencies required that the conduit be "bankruptcy remote," which meant it could hold title to nothing; and courts have started to take notice of this defect. They are concluding that if MERS owns nothing, it can assign nothing, and the chain of title has been irretrievably broken. As foreclosure expert Neil Garfield traces these developments:

First they said it was MERS who was the lender. That clearly didn't work because MERS lent nothing, collected nothing and never had anything to do with the cash involved in the transaction. Then they started with the servicers who essentially met with the same problem. Then they got cute and produced either the actual note, a copy of the note or a forged note, or an assignment or a fabricated assignment from a party who at best had dubious rights to ownership of the loan to another party who had equally dubious rights, neither of whom parted with any cash to fund either the loan or the transfer of the obligation. . . . Now the pretender lenders have come up with the idea that the "Trust" is the owner of the loan . . . even though it is just a nominee (just like MERS) . . . . They can't have it both ways.

My answer is really simple. The lender/creditor is the one who advanced cash to the borrower. . . . The use of nominees or straw men doesn't mean they can be considered principals in the transaction any more than your depository bank is a principal to a transaction in which you buy and pay for something with a check.

**So What's to Be Done?**

Garfield's proposed solution is for the borrowers to track down the real lenders — the

investors. He says:

[I] f you meet your Lender (investor), you can restructure the loan yourselves and then jointly go after the pretender lenders for all the money they received and didn't disclose as "agent."

Karl Denninger concurs. He writes:

Those who bought MBS from institutions that improperly securitized this paper can and should sue the securitizers to well beyond the orbit of Mars. . . . [I]f this bankrupts one or more large banking institutions, so be it. We now have "resolution authority", let's see it used.

The resolution authority Denninger is referring to is in the new Banking Reform Bill, which gives federal regulators the power and responsibility to break up big banks when they pose a "grave risk" to the financial system – which is what we have here. CNBC's Larry Kudlow calls it "the housing equivalent of the credit financial meltdown," something he says could "go on forever."

Financial analyst Marshall Auerback suggests calling a bank holiday. He writes:

Most major banks are insolvent and cannot (and should not) be saved. The best approach is something like a banking holiday for the largest 19 banks and shadow banks in which institutions are closed for a relatively brief period. Supervisors move in to assess problems. It is essential that all big banks be examined during the "holiday" to uncover claims on one another. It is highly likely that supervisors will find that several trillions of dollars of bad assets will turn out to be claims big financial institutions have on one another (that is exactly what was found when AIG was examined—which is why the government bail-out of AIG led to side payments to the big banks and shadow banks). . . . By taking over and resolving the biggest 19 banks and netting claims, the collateral damage in the form of losses for other banks and shadow banks will be relatively small.

What we need to avoid at all costs is "TARP II" – another bank bailout by the taxpayers. No bank is too big to fail. The giant banks can be broken up and replaced with a network of publicly-owned banks and community banks, which could do a substantially better job of serving consumers and businesses than Wall Street is doing now.

***Ellen Brown*** *is an attorney and the author of eleven books. In Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free, she shows how the Federal Reserve and "the money trust" have usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are webofdebt.com, ellenbrown.com, and public-banking.com.*



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