Foreclosure Settlement Bails Out the Big Banks

The report from The New York Times on Wednesday about the foreclosure settlement reached between five big banks and 49 states' attorneys general made it appear that justice was being served. The $26 billion to be paid out to some 2 million homeowners (former and current) "could provide relief" to them under the terms of the settlement. It would also remove a cloud of uncertainty from the banks' liability and might help in "halting the housing market's downward slide."

States' attorneys general started an investigation in the fall of 2010 into the mortgage servicing industry when it was discovered that homeowners were being evicted or penalized through improper, incorrect or false paperwork emanating from Bank of America, JPMorgan Chase, Wells Fargo, Citigroup, Ally Financial (formerly GMAC) with the help of Mortgage Electronic Registration Systems, Inc. (MERS).

Over the 14-month investigation the scope broadened and deepened as the extent of the costs and fraudulent abuses was revealed. The settlement means that, on the surface, the money will go to help homeowners affected by the fraud. A million homeowners can expect to have their existing mortgages reduced or their interest rates reduced. Another 750,000 former homeowners will receive, over the next three years, checks estimated to be about $2,000.

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The size of the settlement fades into insignificance in light of the fact that there are more than 1½ million homeowners who are 90 days or more delinquent on their mortgages (but not yet in foreclosure) with another 1.9 million in the foreclosure process. And still another 11 million homeowners are underwater and likely to remain so for the foreseeable future as prices in the housing market have yet to find a bottom.

As expected, U.S. Attorney General Eric Holder considered the settlement a victory: "We are using this opportunity to fix a broken system," he said in announcing it. President Obama added that the settlement will "begin to turn the page on an era of recklessness that has left so much damage in its wake. No action, no matter how meaningful, is going to by itself entirely heal the housing market. But this settlement is a start."

David Stockman, President Reagan's budget director, was one of the first to see the reality of the settlement:

> There are 110 million households in this country, 35 million are renters, it does nothing for them. Thirty million own their homes free and clear with no mortgage, it does nothing for them. Of the 50 million with mortgages, 40 million aren't underwater and have recently refinanced or have no reason to refinance
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> So what you are basically doing its picking out a pool of 10 million households with mortgages that are underwater or deeply underwater, and you are basically going to come in and offer some free money and again interfere with the market's ability to sort this out.
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> What it will really do is help big banks conveniently get bad mortgages off their books.
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> This is ultimately…a bailout for JP Morgan and Wells Fargo and other big underwriters of second mortgages and home equity lines.

After his careful review of the history behind the foreclosure fraud, David Dayen agreed with Stockman: “One thing is clear — the banks relieved themselves of a significant portion of liability at a price they believe they can easily handle.” Yves Smith, writing in *Naked Capitalism*, called the settlement “bush league” compared to the damage wrought by the fraud. The actual hard-dollar cost of the settlement to the banks, instead of the touted $26 billion, is only about $5 billion. $17 billion consists of credits for principal modifications which will injure the investors holding the mortgages, while $3 billion will be allocated for refinancings. When divided by the number of homeowners foreclosed between September 2008 and December 2011, each victim will receive between $1,500 and $2,000, spread over three years. This means that, says Dayen: “We’ve now set a price for forgeries and fabricating documents. It’s $2,000 per loan.” He added:

> This is a rounding error compared to the chain of title problem these systematic practices were designed to circumvent. The cost is also trivial in comparison to the average loan, which is roughly $180k, so the settlement represents about 1% of loan balances. It is less than the price of the title insurance that banks failed to get when they transferred the loans to the trust. It is a fraction of the cost of the legal expenses when foreclosures are challenged. It’s a great deal for the banks because no one is at any of the servicers going to jail for forgery and the banks have set the upper bound of the cost of riding roughshod over 300 years of real estate law.

In addition it removes the risk of default on second mortgages from the banks which actually improves the health of the banks’ financial statements. As Smith expressed it: “This deal is a stealth bailout that strengthens bank balance sheets at the expense of the broader public.”

And enforcement is likely to be lax as well. The first layer of enforcement “is the banks reporting on themselves.” Smith called it “regulatory theatre.”

Finally, no one is going to jail over this massive fraud. A good example is the previous settlement that Countrywide Financial made which is now being “rolled over” into the settlement announced on Wednesday. Smith says this rollover “is a special gift for Bank of America who is by far the worst offender in the chain of title disaster…This move proves that failing to comply with a consent decree has no consequences but will merely be rolled into a new consent decree which will also fail to be enforced.” Smith concluded:

> This settlement is yet another raw demonstration of who wields power in America, and it isn’t you and me.