The 2012 Mortgage Settlement: Who Gains?

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On February 9, 2012, five of the leading mortgage lenders came to a settlement with 49 of the 50 states attorneys general\(^1\) for a sum of approximately $25 billion.\(^2\) These five lenders- Bank of America, Wells Fargo, JPMorgan Chase, Citigroup, and Ally Financial- agreed to settle claims of abuse made against them by separate state’s Attorneys General that arose over alleged robo-signing and other frauds.\(^3\) This settlement represents the largest financial recovery involving a single industry since an agreement with the tobacco industry in 1998. To fully understand why this settlement was reached and the numerous positive effects, we must examine the recent mortgage crisis and how banks’ actions led to this point.

The Recent Crisis: Mortgages on the Rise

From 2007 to 2009, foreclosure rates in the United States tripled.\(^4\) In addition, in the fourth quarter of 2010, nearly a quarter of homes with mortgages were underwater.\(^5\) Probably as a result of such foreclosure rates, the number of households who owned their own home has fallen since a high of 69% in 2004 to 64%.\(^6\)

As a result, banks, and their debt collectors, have experienced a meteoric rise in the number of defaults and foreclosures that they have had to process. However, as one recent audit carried out by San Francisco officials indicated, a high percentage of foreclosures contain some sort of illegal activity.\(^7\) Nearly 84% of the foreclosure files that the officials examined (approximately 400 files total) contained clear violations of the law.\(^8\) Two-thirds of those files contained four or more violations or irregularities.\(^9\) The abuses found on these foreclosures included failing to warn the borrower that the loan was in default and assigning the loan without authority to do so.

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\(^2\) Philip A. Lehman, Executive Summary of Multistate/Federal Settlement of Foreclosure Misconduct Claims 1, http://www.atg.wa.gov/uploadedFiles/Home/About_the_Office/Cases/National_Mortgage_Settlement/National_Settlement.Executive.Summary.pdf (last visited March 5, 2011)(while the settlement document itself has not been released, a summary of the points has been).

\(^3\) See Kravitz, *supra* note 1.


\(^5\) *Id.*

\(^6\) *Id.* at 11.


\(^8\) *Id.*

\(^9\) *Id.*
These practices allowed companies to process foreclosures without actually verifying the ownership or authenticity of all the documents. As a result, without ever reading or examining the documents, a company could have pursued foreclosure against someone who was not even in default. Also, lenders could deny borrowers a full opportunity to pursue their defenses due to the sped up process.

The federal government has put in place a number of laws and programs to try to regulate the mortgage industry and educate borrowers about the loans that they are entering into. The newly created Consumer Financial Protection Bureau (“CFPD”), created by the Dodd-Frank Act, also attempts to provide an outlet for consumers to let their voices be heard. The CFPD seeks to require additional disclosures to help the consumer understand their loan, and they have also created a single location for consumer complaints regarding their mortgage.10 These steps can rarely take the place of a well-informed attorney meticulously investigating the entirety of an individual’s foreclosure case, but few consumers in default can actually afford the legal fees. As a result, the basic, uninformed consumer is left with little, if any, real recourse against a bank that is improperly foreclosing on them.

The administration has also created programs to help borrowers in default who do not have access to an attorney. The Making Home Affordable Program allows consumers who have borrowed certain loans to lower monthly mortgage payments, allows some to exit their home but avoid foreclosure, and provides some assistance to borrowers who owe more than their home is worth.11 One arm of this program, for instance, the Home Affordable Modification Program, permits borrowers to refinance their loans with banks to gain a lower monthly payment amount.12 This program has helped more than 4.6 million Americans acquire housing aid to and prevent foreclosures.13

Despite the intense criticism and backlash, the banks, or their debt collectors, appear to still engage in this activity.14 This settlement represents another attempt by the government to maintain standards of fairness in the lending industry and an important step towards holding the banks accountable for their past and future behavior.

The Settlement

After 10 months of negotiations, the states, banks, and various federal agencies15 finally came to a settlement agreement. State attorneys general launched a probe in October, 2010, into the robosigning allegations, an investigation which grew to encompass other mortgage servicing issues and

13 Id.
14 See Morgenson, supra note 7.
15 Federal agencies included the Department of Justice, Treasury, and Housing and Urban Development. See Lehman, supra note 2 at 1.
include the assistance of various federal organizations and banking regulators. While the full details of the settlement are unclear, the terms appear to represent a positive gain for both the consumer and the banks. Of the $25 billion, the banks must use $17 billion to assist borrowers who can make reasonable payments on their homes. This amount would reduce the principal debt for a number of borrowers, as well as provide other assistance, such as increased short sales, relocation assistance, etc. The settlement forces banks to increase their refinancing programs, using approximately $3 billion, to assist borrowers who owe more than the value of the property and have interest rates higher than 5.25%.

The settlement also reforms many mortgage servicing practices, to keep banks from fraudulent practices like robo-signing. Under these new procedures, banks must oversee foreclosure firms, increase their loss mitigation obligations to keep borrowers in their homes, and restrict the amounts of default fees. In addition to forestalling improper foreclosure practices, these new standards seek to make the foreclosure process less economically burdensome for the borrower. These procedures will be overseen by a monitor who will make reports to attorneys general, and civil penalties can be assessed for violations of the settlement. This independent monitor, as the administration recently detailed, will assess the bank’s compliance with the agreement through a set of specific standards, which will be reported to the public.

$1.5 billion of the funds will go to borrowers foreclosed upon after January 1, 2008, and the banks must send $2,000 to each borrower who was improperly foreclosed upon. $2.5 billion will be paid to the states to use in their foreclosure assistance programs. The amounts given to each state are determined based on the state’s share of a combination of loans, foreclosures, seriously delinquent loans, and loans with negative equity in the state. California and Florida, two of the hardest hit states, stand to gain about 75% of these funds.

Because of the banks’ concessions, the states and banking regulators have agreed not to pursue civil claims against the banks for previous misconduct relating to mortgages. However, states can pursue other banks not named in the settlement, and private causes of action are still available for both homeowners who were improperly foreclosed upon and private groups who might have claims relating to securities they invested in with the banks. Criminal charges can also still be filed.

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17 See Lehman, supra note 2 at 2.
18 Id.
19 Id. at 3.
20 Id.
21 Id. at 3-4.
23 Id. at 4.
24 Id.
26 See Kravitz, supra note 1.
27 See Lehman, supra note 2 at 4.
Implications

The settlement agreement represents a victory for the consumer. The five main lending banks are paying out for the multitude of violations that they appear to have committed. Furthermore, the settlement will aid thousands who were improperly foreclosed upon since 2008 and assist those in compromised mortgages now.

This settlement offers assistance for borrowers not interested in engaging in their own lengthy and costly litigation. While banks may have perpetuated more frauds than originally believed, the settlement does not destroy individuals’ right to litigate. It does, however, allow the banks to continue business without threat of civil lawsuits from the government.

On the other hand, many look at the settlement amount as insignificant. For those who were improperly foreclosed upon, the $2,000 that they received might not even pay for their moving costs. This settlement also would only help a single million of the eleven million households who owe more than their homes are worth.

Despite the small sum, states can still pursue criminal charges against the banks. If the government desires to change the banks’ behavior, criminal charges will probably be just as effective as steep civil penalties. The settlement amount allows the banks to be punished without putting them out of business, an action that might do more harm than good to the struggling U.S. economy.

The consumer, on the other hand, receives some modest financial help without sacrificing their own litigation rights. Individual borrowers, unhappy with this settlement, can still pursue claims against the banks on their own. Furthermore, additional banks not a party to this settlement, who might have attributed to the foreclosure violations, could enter a similar settlement at a later date.

Any claims that the settlement amount is too low are unfounded. If the borrowers do feel that they were taken advantage of by the banks, they can file their own claims and seek their own relief. The settlement does not affect an individual’s private right of action. This agreement instead serves to make immediate modifications to the mortgage services industry to prevent further fraud and gain some relief for mortgagees who might have been improperly foreclosed upon. The settlement allows the banks to continue to do business without bankrupting them, and allows the consumer to receive some immediate assistance that can be augmented if they desire to do so. As a result, all sides appear to have gained from this settlement.

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28 See Kravitz, supra note 1.
29 Id.