Settlements Actually Mean Anything? FinCen's Impact on Non-bank Mortgage Lenders

By: Rob Chrisman | Fri, Feb 10 2012, 9:31 AM

"Fat, drunk & stupid is no way to go through life son." One probably doesn't hear that admonishment much in the halls of the Financial Crimes Enforcement Network (FinCEN), which finalized regulations that **require non-bank residential mortgage lenders and originators to establish anti-money laundering (AML) programs and file suspicious activity reports (SARs)**, as FinCEN requires of other types of financial institutions.

Law firm **Ballard Spahr** was quick to set up a free webinar for its attorneys to explain the new requirements and discuss the steps non-bank residential mortgage lenders and originators must take now to comply with the new requirements. Mortgage banks, who now have this new regulatory worry on their plate, may want to have someone sit in next Thursday (2/16) from 12-1 EST. For more information, contact Lora Burns at burnsl@ballardspahr.com. (Mortgage bankers have certainly become a growth industry for law firms everywhere.)

With this in mind, all kinds of things are being "settled" out there. (I am sure that many mortgage bankers wish their repurchases were being settled, which, on the flip side, is consuming the lives of many investor reps...) First, **a "settlement" agreement was announced regarding Germany's bailout of Greece**. Announcing it is one thing but carrying it out is another, as anyone who tries to lose 10 pounds will tell you. It is unclear whether the Greek people will accept austerity, whether it will be enforced, or whether Germany and other EU members will recognize it as enough. **The markets had pretty much priced this in**, so that the markets almost didn't care when Greek leaders agreed to the austerity measures tied to the next installment of its aid package.

Second, the Federal Reserve Bank of New York sold $6.2 billion worth of residential MBS to Goldman Sachs, its second major sale this year of assets acquired in the 2008 government bailout of insurer AIG. The auction-based sale will enable the New York Fed to recoup the remaining outstanding loan balance of $19.5 billion to the portfolio called Maiden Lane II. Those keeping track remember that Credit Suisse bought a $7.01 billion chunk of the portfolio three weeks ago after an auction.

Third, the U.S. Attorney for the Eastern District of New York announced the **settlement of claims** her office had brought against Bank of America, Countrywide Financial Corporations and some of its affiliates for underwriting and origination mortgage fraud on loans to unqualified borrowers and insured by the FHA. Of the $1 billion, there is an immediate payment of $500 million to correct some of the harm done to FHA by Countrywide's conduct. The remaining $500 million will be deferred to fund a loan modification program for borrowers across the nation with Countrywide mortgages that are under water.

And now the press can stop speculating on the **servicing settlement**: a final settlement between the nation's five largest mortgage servicers, two federal agencies and 49 of the states' attorneys general (AGs) was announced Thursday. (Ok, Oklahoma, what's the deal?) The market measured this as **a slight positive for banks as the uncertainty of the settlement is cleared up and banks can now focus on moving forward on foreclosures**. Bank of America, JPMorgan Chase & Co., Wells Fargo & Company, Citibank, and Ally Financial, (formerly GMAC) and their servicing subsidiaries have agreed to commit a minimum of $17 billion directly to borrowers through a series of relief effort options including principal reduction.

For more granularity, the ponying-up consists of Ally/GMAC ($310 mil), BofA ($11.8 billion), Citi ($2.2 billion), JP Morgan ($5.3 billion), and Wells Fargo ($5.4 billion) for $25 billion. Servicers will likely provide up to an estimated $32 billion in direct homeowner relief. There will be $4.2 billion paid directly to the states and $750 million to the federal government. In addition, a comprehensive set of new standards will be implemented to protect homeowners from future abuses and an independent monitor will be appointed to ensure servicer compliance. HUD Secretary Shaun Donovan has also commented that the total cost may increase to $45bn if additional banks sign onto the settlement deal.

Of course this does little to stop future lawsuits against these piñatas of the financial world**.** Nothing in the agreement grants any immunity from criminal offenses and will not affect criminal prosecutions. The agreement does not prevent homeowners or investors from pursuing individual, institutional or class action civil cases against the five servicers. The pact also enables state attorneys general and federal agencies to investigate and pursue other aspects of the mortgage crisis, including securities cases. The settlement only covers servicer liability for robo-signing and improper mortgage servicing. Notably, it does not cover any wrongdoings associated with mortgage securitizations, MERS, or any criminal liability.

"Because of the complexity of the mortgage market and this agreement, which will span a three year period, borrowers in some cases may be contacted directly by one of the five included mortgage servicers regarding loan modification offers, may be contacted by a settlement administrator or their state attorney general, or may need to contact their mortgage servicer to obtain more information about specific programs and whether their loan qualifies. More information will be made available as the settlement programs are implemented."

Barclays Capital broke down the numbers. $17 billion will come in the form of principal reductions on first and second lien mortgages ($10 billion), forbearance modifications, and costs to facilitate short sales. Principal reductions will not be applied to any loans in agency MBS trusts, and for principal reductions on non-agency loans or in bank portfolios, the servicer must determine that the modification results in a higher NPV than foreclosing on the home. $3 billion of the settlement cost will come in the form of refinancings for borrowers who are current on their mortgage payments but underwater. $1.5 billion, per Barclays, will be used to provide immediate cash payments of up to $2,000 to borrowers who lost their homes to foreclosure between January 1, 2008 and December 31, 2011.

The modifications, refinancings, and borrower payments outlined in the settlement will be performed over three years, with 75% of each bank's target required to be reached within two years. Servicers will identify borrowers eligible for these benefits over the next six to nine months. Banks that fall short of their settlement targets by the deadlines will be assessed cash penalties. Joseph Smith, the former North Carolina Commissioner of Banks, has been selected as a third party monitor to provide oversight of the participating bank servicers.

As part of the settlement, the participating banks will be required to comply with new servicing standards, most of which likely have already been implemented or are in the process of being incorporated into standard servicing procedures. (They are too numerous to repeat here.)

If you were a bank, wouldn't you try to modify as many non-portfolio loans as possible through this program since while they only get a 50% credit, banks also escape the actual monetary costs of forgiveness? However, this may not be possible for multiple reasons, and things become pretty complicated. For one thing, Barclays notes, the bank servicers will have to follow some NPV rules to make a judgment on whether to apply a principal forgiveness modification. All of the five servicers are part of the HAMP program and have presumably already been applying NPV tests to delinquent loans and have already determined on which loans a debt forgiveness modification would make sense. This settlement cannot change that assessment. Of course, more loans could be modified through debt forgiveness due to the increased HAMP PRA incentives that were announced a few weeks ago but this settlement does not change the NPV calculation beyond that.

So what can we gather from all this? As I told one reader, the whole thing was pretty much greeted with a shrug rather than champagne corks popping, especially since it certainly doesn't end many types of lawsuits. For the impact on non-agency RMBS modifications it is small, but will keep foreclosure rolls slow for another 6-12 months. The details released specifically exclude Fannie Mae/Freddie Mac pools from this settlement but one can expect that loans in private-label pools will be affected. It seems that the banks will be required to target the $17 billion in forgiveness and other relief, and will receive a 125% credit for every dollar of forgiveness that they apply to portfolio loans - but only a 50% credit for every dollar of forgiveness applied on loans that they service but do not own. The program will have a significant impact on liquidation timelines as it is likely to slow down 90+ delinquencies to foreclosure and foreclosure to REO roll rates as servicers take some time to adjust to the new servicing standards. After that, however, we expect these rates to pick up and rise to levels higher than that experienced over the past 12-24 months.

The U.S economy continues to show some signs of life. Yesterday Jobless Claims decreased 15,000 in the week ended Feb. 4 to 358,000, with the important 4-week moving average down to 366,250. Wholesale Sales were up 1.3% in December from the revised November level and were up 11.8% from the December 2010 level. Yesterday's $16 billion 30-yr bond auction went pretty well, but the 10-yr worsened .250 closing at 2.05%. In mortgage-land, ThomsonReuters noted that, "mortgage banker supply in the $2.0 billion area weighed as well as the Fed's buying has been about $1.25 billion per day on average." Rate-sheet MBS prices declined/worsened about .250.

This morning we've had some December International Trade figures which showed the deficit climbing from $47.1 to $48.8 billion. Later we have the University of Michigan Consumer Sentiment number. At 12:30PM EST Chairman Bernanke speaks on "Housing Markets in Transition" at the 2012 National Association of Homebuilders International Builders' Show from Orlando, Florida. **In the early going the 10-yr is down to 1.97% and MBS prices are .125-.250 better.**

With Valentine's Day approaching, you will be able to impress the object of your affection with some caring phrases. Here is "I LOVE YOU" in 10 languages, guaranteed to upset some readers.
English "I Love You"
Spanish "Te Amo"
French "Je T'aime"
German "Ich Liebe Dich"
Japanese "Ai Shite Imasu"
Italian "Ti Amo"
Chinese "Wo Ai Ni"
Swedish "Jag Alskar Dig"

Lithuanian "As Tave Meliu"
Alabama, Arkansas, Oklahoma, Texas, Louisiana, South Carolina, Georgia, Tennessee, Florida, Mississippi , Kentucky, North Carolina, West Virginia, Virginia, Manitoba, Saskatchewan, Alberta "Nice Rack, Get in the Truck".

If you're interested, visit my twice-a-month blog at the STRATMOR Group web site located at www.stratmorgroup.com. The current blog discusses residential lending and mortgage programs around the world, part 2. If you have both the time and inclination, make a comment on what I have written, or on other comments so that folks can learn what's going on out there from the other readers.

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