SZYMONIAK FRAUD ARTICLE

"INROADS ON FORECLOSURE FRAUD"

INROADS ON FORECLOSURE FRAUD BY MORTGAGE SERVICERS

BY Lynn E. Szymoniak, Esq., Editor, Fraud Digest (szymoniak@mac.com), April 7, 2010

Fannie Mae announced a rule change effective May 1, 2010, involving MERS, Mortgage Electronic Registration Systems, Inc. According to Fannie Mae, *Servicing Guide,* Part VIII, 105: Conduct of Foreclosure Proceedings, MERS must not be named as a plaintiff in any foreclosure action, whether judicial or non-judicial, on a mortgage loan owned or securitized by Fannie Mae.

According to the new rule, if MERS is the mortgagee of record, either because the mortgage named MERS as the original mortgagee or a completed and recorded assignment named MERS as the mortgagee assignee, Fannie Mae directs: "the servicer must prepare a mortgage assignment from MERS to the servicer, and then bring the foreclosure in its own name, unless Fannie Mae specifically requires that the foreclosure be brought in the name of Fannie Mae. In that event, the assignment must be from MERS to Fannie Mae, in care of the servicer at the servicer's address for receipt of notices. In all cases, the assignment from MERS to the servicer or Fannie Mae must be recorded before the foreclosure begins."

The rule also precludes servicers from charging Fannie Mae for correcting these MERS assignments, providing: "Fannie Mae will not reimburse the servicer for any expense incurred in preparing or recording an assignment of the mortgage loan from MERS to the servicer or to Fannie Mae."

In the past three years, many of the major mortgage servicing companies have prepared and filed mortgage assignments from MERS to securitized trusts so that the trusts could foreclose. Recently, however, more courts have recognized that the assignment by MERS was erroneous because 1) there was never an assignment to MERS from the original lender in most cases; and 2) such an assignment would have been erroneous because MERS never owned legal title to mortgages registered on its database. Christopher L. Peterson, Associate Dean of Academic Affairs and Professor Of Law, Univerity of Utah, S.J. Quinney College of Law, sets forth the authority for the conclusion that MERS is not a mortgagee with respect to any loan registered on its database in his comprehensive article, "Foreclosure, Subprime Mortgage Lending, and The Mortgage Electronic Registration System." Courts have split regarding whether foreclosure actions can be brought in the name of MERS, with a definite trend toward dismissing such actions. With this rule change, Fannie Mae officials seem to acknowledge the problem with MERS assignments.

While Fannie Mae officials may have addressed the problem of foreclosures brought in the name of MERS, they may have also created another significant problem by advising mortgage servicing companies to file foreclosure actions in their own names. Does a mortgage servicing company have any better claim to ownership than MERS? Many courts have already concluded that servicing companies are also lack ownership interest and standing to foreclose.

If a mortgage is part of a securitized trust, there should be a transfer from the original lender, to a depositor, to a securities company to a trust. Transfers by servicers are most often transfers by an entity with no ownership interest to transfer in the first place because most of the servicers have gotten their rights from MERS and MERS itself had no ownership interest.

The Assignments from and to MERS and servicers are most often used when the assignments that should have occurred as part of the securitization process are missing. Servicers and default management companies working for the securitized trusts often use questionable tactics when the trusts cannot produce the documents, particularly the mortgage assignments, necessary to foreclose. In a case pending in the United States Bankruptcy Court for the Southern District of New York, for example, *In re Silvia Nuer*, Case No. 08-17106 (REG), in a Memorandum of Law of the United States Trustee in Support of Sanctions Against J.P.Morgan Chase Bank National Association, filed January 4, 2010, the Trustee reviewed the testimony of Mr. Herndon, a witness for Chase, who testified that the chain of title for the property in question passed through three entities. "The original lender in connection with the loan was the Long Beach Mortgage Company, as evidenced by the Note and Mortgage listing Long Beach Mortgage Company as the initial owner."

Regarding the next owner, the Memorandum states: "Next, Mr. Herndon testified that Long Beach Securities Corporation bought the Mortgage. Mr. Herndon acknowledged that the Motion for Stay Relief did not contain a reference to the Long Beach Securities Corporation or any documentation in connection therewith...Mr. Herndon testified that he knew that Long Beach Securities Corporation purchased the Mortgage because he had reviewed a mortgage loan purchase agreement dated February 24, 2006 between the Long beach Securities Corp. as purchaser and the Long Beach Mortgage Company as seller..."

Regarding the next owner, the Memorandum states: "The third owner of the Mortgage, according to the testimony, was the Long Beach Mortgage Trust 2006-2...Mr. Herndon based his knowledge of this assignment on the system notes of Chase as well as the pooling and servicing agreement dated March 1, 2006 (the "PSA")...Mr. Herndon stated that the PSA had a reference to the Mortgage on Exhibit A."

Previously, Chase had submitted contrary documents. In particular, Chase had submitted an assignment "that appeared to show that Chase assigned its right *as mortgagee* to Deutsche, as trustee for Long Beach Mortgage Trust 2006-2. The Assignment was signed by Scott Walter as "Attorney in Fact for Chase (the "Walter November 1 Assignment")...It was signed on November 1, 2008, after the Filing Date. This 2008 Assignment to a trust that closed in 2006 signed by an individual who did not in fact work for Chase has become the focus of the sanctions debate. Regarding the Walter Assignment, the Trustee states: "Here, the misconduct of Chase includes the attachment of the Walter November 1 Assignment...Chase's own witness could not explain the Walter November 1 Assignment..."

Walter was actually an employee in the Minnesota office of Lender Processing Services, a company that "drafts missing documents."

This scenario is familiar. In the case of *Niles and Angela Taylor*, 2009 WL 1885888 (Bankr. E.D. Pa. 2009), Judge Diane Weiss Sigmund also determined that sanctions were warranted in a foreclosure case involving Lender Processing Services. Judge Sigmund described in great detail how the default mortgage servicing and foreclosure systems really work.

Lender Processing Services ("LPS") was described as the largest out-source provider in the United States for mortgage default services. The LPS systems frequently resulted in incorrect information regarding mortgages reported to litigants and judges in foreclosure actions. The LPS network of national and local law firms were required to communicate directly with LPS, and not the mortgage servicers, about any issues that arose in any given case. Likewise, the servicers were required to execute a 51-page Default Service Agreement with LPS that delegated to LPS all functions with respect to the default servicing work. LPS used a software communication system called "NewTrak" to deliver instructions and documents to the LPS network attorneys and to deliver any information to the servicers. LPS also had access to the servicers data-base platforms. The law firms were staffed primarily by paralegals with little supervision by attorneys. See *In re Taylor*, supra, at 1885889 to 1885891.

Judge Sigmund found that he LPS system was designed to minimize human involvement. She concluded, "When an attorney appears in a matter, it is assumed he or she brings not only substantive knowledge of the law but judgment. The competition for business cannot be an impediment to the use of these capabilities. The attorney, as opposed to the processor, knows when a contest does not fit the cookie cutter forms employed by the paralegals. At that juncture, the use of technology and automated queries must yield to hand-carried justice. The client must be advised, questioned and consulted. The thoughtless mechanical employment of computer-driven models and

communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system. It is for those involved in the process to step back and assess how they can fulfill their professional obligations and responsibly reap the benefits of technology. Noting less should be tolerated."

On February 18, 2010, the District Court reversed the sanctions determination, finding that Judge Sigmund abused her discretion. In the battle between bankers and the integrity of the American court system, bankers continue to win overwhelmingly, but MERS will no longer be as significant a weapon in their arsenal.