CONGRESSIONAL OVERSIGHT PANEL

NOVEMBER OVERSIGHT REPORT *

EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE MITIGATION

NOVEMBER 16, 2010.—Ordered to be printed

*Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343
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EXECUTIVE SUMMARY *

In the fall of 2010, reports began to surface alleging that companies servicing $6.4 trillion in American mortgages may have bypassed legally required steps to foreclose on a home. Employees or contractors of Bank of America, GMAC Mortgage, and other major loan servicers testified that they signed, and in some cases backdated, thousands of documents claiming personal knowledge of facts about mortgages that they did not actually know to be true. Allegations of "robo-signing" are deeply disturbing and have given rise to ongoing federal and state investigations. At this point the ultimate implications remain unclear. It is possible, however, that "robo-signing" may have concealed much deeper problems in the mortgage market that could potentially threaten financial stability and undermine the government's efforts to mitigate the foreclosure crisis. Although it is not yet possible to determine whether such threats will materialize, the Panel urges Treasury and bank regulators to take immediate steps to understand and prepare for the potential risks.

In the best-case scenario, concerns about mortgage documentation irregularities may prove overblown. In this view, which has been embraced by the financial industry, a handful of employees failed to follow procedures in signing foreclosure-related affidavits, but the facts underlying the affidavits are demonstrably accurate. Foreclosures could proceed as soon as the invalid affidavits are replaced with properly executed paperwork.

The worst-case scenario is considerably grimmer. In this view, which has been articulated by academics and homeowner advocates, the "robo-signing" of affidavits served to cover up the fact

* The Panel adopted this report with a 5–0 vote on November 15, 2010.
that loan servicers cannot demonstrate the facts required to conduct a lawful foreclosure. In essence, banks may be unable to prove that they own the mortgage loans they claim to own.

The risk stems from the possibility that the rapid growth of mortgage securitization outpaced the ability of the legal and financial system to track mortgage loan ownership. In earlier years, under the traditional mortgage model, a homeowner borrowed money from a single bank and then paid back the same bank. In the rare instances when a bank transferred its rights, the sale was recorded by hand in the borrower's county property office. Thus, the ownership of any individual mortgage could be easily demonstrated.

Nowadays, a single mortgage loan may be sold dozens of times between various banks across the country. In the view of some market participants, the sheer speed of the modern mortgage market has rendered obsolete the traditional ink-and-paper recordation process, so the financial industry developed an electronic transfer process that bypasses county property offices. This electronic process has, however, faced legal challenges that could, in an extreme scenario, call into question the validity of 33 million mortgage loans.

Further, the financial industry now commonly bundles the rights to thousands of individual loans into a mortgage-backed security (MBS). The securitization process is complicated and requires several properly executed transfers. If at any point the required legal steps are not followed to the letter, then the ownership of the mortgage loan could fall into question. Homeowner advocates have alleged that frequent "robo-signing" of ownership affidavits may have concealed extensive industry failures to document mortgage loan transfers properly.

If documentation problems prove to be pervasive and, more importantly, throw into doubt the ownership of not only foreclosed properties but also pooled mortgages, the consequences could be severe. Clear and uncontested property rights are the foundation of the housing market. If these rights fall into question, that foundation could collapse. Borrowers may be unable to determine whether they are sending their monthly payments to the right people. Judges may block any effort to foreclose, even in cases where borrowers have failed to make regular payments. Multiple banks may attempt to foreclose upon the same property. Borrowers who have already suffered foreclosure may seek to regain title to their homes and force any new owners to move out. Would-be buyers and sellers could find themselves in limbo, unable to know with any certainty whether they can safely buy or sell a home. If such problems were to arise on a large scale, the housing market could experience even greater disruptions than have already occurred, resulting in significant harm to major financial institutions. For example, if a Wall Street bank were to discover that, due to shoddily executed paperwork, it still owns millions of defaulted mortgages that it thought it sold off years ago, it could face billions of dollars in unexpected losses.

Documentation irregularities could also have major effects on Treasury's main foreclosure prevention effort, the Home Affordable Modification Program (HAMP). Some servicers dealing with Treasury may have no legal right to initiate foreclosures, which may call
into question their ability to grant modifications or to demand payments from homeowners. The servicers’ use of “robo-signing” may also have affected determinations about individual loans; servicers may have been more willing to foreclose if they were not bearing the full costs of a properly executed foreclosure. Treasury has so far not provided reports of any investigation as to whether documentation problems could undermine HAMP. It should engage in active efforts to monitor the impact of foreclosure irregularities, and it should report its findings to Congress and the public.

In addition to documentation concerns, another problem has arisen with securitized mortgage loans that could also threaten financial stability. Investors in mortgage-backed securities typically demanded certain assurances about the quality of the loans they purchased: for instance, that the borrowers had certain minimum credit ratings and income, or that their homes had appraised for at least a minimum value. Allegations have surfaced that banks may have misrepresented the quality of many loans sold for securitization. Banks found to have provided misrepresentations could be required to repurchase any affected mortgages. Because millions of these mortgages are in default or foreclosure, the result could be extensive capital losses if such repurchase risk is not adequately reserved.

To put in perspective the potential problem, one investor action alone could seek to force Bank of America to repurchase and absorb partial losses on up to $47 billion in troubled loans due to alleged misrepresentations of loan quality. Bank of America currently has $230 billion in shareholders’ equity, so if several similar-sized actions—whether motivated by concerns about underwriting or loan ownership—were to succeed, the company could suffer disabling damage to its regulatory capital. It is possible that widespread challenges along these lines could pose risks to the very financial stability that the Troubled Asset Relief Program was designed to protect. Treasury has claimed that based on evidence to date, mortgage-related problems currently pose no danger to the financial system, but in light of the extensive uncertainties in the market today, Treasury’s assertions appear premature. Treasury should explain why it sees no danger. Bank regulators should also conduct new stress tests on Wall Street banks to measure their ability to deal with a potential crisis.

The Panel emphasizes that mortgage lenders and securitization servicers should not undertake to foreclose on any homeowner unless they are able to do so in full compliance with applicable laws and their contractual agreements with the homeowner.

The American financial system is in a precarious place. Treasury’s authority to support the financial system through the Troubled Asset Relief Program has expired, and the resolution authority created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 remains untested. The 2009 stress tests that evaluated the health of the financial system looked only to the end of 2010, providing little assurance that banks could withstand sharp losses in the years to come. The housing market and the broader economy remain troubled and thus vulnerable to future shocks. In short, even as the government’s response to the financial crisis is drawing to a close, severe threats remain that have the potential to damage financial stability.
SECTION ONE:

A. Overview

In the fall of 2010, with the Troubled Asset Relief Program’s (TARP) authority expiring, reports began to surface of problems with foreclosure documentation, particularly in states where foreclosures happen through the courts. GMAC Mortgage, a subsidiary of current TARP recipient Ally Financial, announced on September 24, 2010 that it had identified irregularities in its foreclosure document procedures that raised questions about the validity of foreclosures on mortgages that it serviced. Similar revelations soon followed from Bank of America, a former TARP recipient, and others. Employees of these companies or their contractors have testified that they signed, and in some cases backdated, thousands of documents attesting to personal knowledge of facts about the mortgage and the property that they did not actually know to be true. Mortgage servicers also appeared to be cutting corners in other ways. According to these banks, their employees were having trouble keeping up with the crush of foreclosures, but additional training and employees would generally suffice to get the process in order again.

At present, the reach of these irregularities is unknown. The irregularities may be limited to paperwork errors among certain servicers in certain states; alternatively, they may call into question aspects of the securitization process that pooled and sold interests in innumerable mortgages during the housing boom. Depending on their extent, the irregularities may affect both Treasury’s ongoing foreclosure programs and the financial stability that Treasury, under the Emergency Economic Stabilization Act of 2008 (EESA), was tasked with restoring. Further, the mortgage market faces ongoing risks related to the right of mortgage-backed securities to force banks to repurchase any loans. Losses stemming from these repurchases would compound any risks associated with documentation irregularities.

Under EESA, the Congressional Oversight Panel is charged with reviewing the current state of the financial markets and the regulatory system. The Panel’s oversight interest in foreclosure documentation irregularities stems from several distinct concerns:

**If Severe Disruptions in the Housing Market Materialize, Financial Stability and Taxpayer Funds Could Be Imperiled.** If document irregularities prove to be pervasive and, more importantly, throw into question ownership of not only foreclosed properties but also pooled mortgages, the result could be significant harm to financial stability—the very stability that the TARP was designed to protect. In the worst case scenario, a clear chain of title—an essential element of a functioning housing market—may be difficult to establish for properties subject to mortgage loans that were pooled and securitized. Rating agencies are already cautious in their outlook for the banking sector, and further blows could have a significant effect. The implications could also be dire for taxpayers’ recovery of their TARP investments. Treasury still has $66.8 billion invested in the banking sector generally, and as the Panel discussed in its July report, “Small Banks in the Capital
Taxpayers may also be at risk for losses related to Treasury’s investment in AIG. The Maid-
en Lane II and Maiden Lane III vehicles, which the Federal Reserve Bank of New York (FRBNY) created to hold assets purchased from AIG, hold substantial amounts of residential mortgage-backed securities (RMBSs), most of which are either sub-prime or Alt-A mortgages originated during the housing boom. Treasury’s ability to recover the funds it has put into AIG depends in significant part on FRBNY’s ability to collect on these investments, and uncertainty associated with the investments could hinder that process.

HAMP May Rely on Uncertain Legal Authority and Inaccurate Foreclosure Cost Estimates, Potentially Posing a Risk to Foreclosure Mitigation Efforts. If irregularities in the foreclosure process reflect deeper failures to document properly changes of ownership as mortgage loans were securitized, then it is possible that Treasury is dealing with the wrong parties in the course of the Home Affordable Modification Program (HAMP). This could mean that borrowers either received or were denied modifications improperly. Some servicers dealing with Treasury may have no legal right to initiate foreclosures, which may call into question their ability to grant modifications or to demand payments from homeowners, whether they are part of a foreclosure mitigation program or otherwise. The servicers’ tendency to cut corners may also have affected the determination to modify or foreclose upon individual loans. Because the net present value (NPV) model compares the net present value of the modification to a foreclosure, improper procedures that cut corners might have affected the foreclosure cost calculation and thus might have affected the outcome of the NPV test.

TARP-Recipient Banks May Have Failed to Meet Legal Obligations. Many of the entities implicated in the recent document irregularities, including Ally Financial, Bank of America, and JPMorgan Chase, are current or former TARP recipients. Ally Financial, notably, remains in TARP and is in possession of $17.2 billion in taxpayer funds. Bank of America received funds not only from TARP’s Capital Purchase Program (CPP) but also what Treasury deemed “exceptional assistance” from TARP’s Targeted Investment Program (TIP). Some of the banks involved were also subject to the Supervisory Capital Assessment Program (SCAP), also known as the stress tests: Treasury’s and the Board of Governors of the Federal Reserve’s (Federal Reserve) efforts to determine the health of the largest banks under a variety of stressed scenarios.

The Congressional Oversight Panel will continue to monitor Treasury’s engagement with these ongoing events, not only to protect the taxpayers’ existing TARP investments and to oversee its foreclosure mitigation programs, but also to meet the Panel’s statutory mandate to “review the current state of the financial markets and the regulatory system.”

B. Background

In the fall of 2010, a series of revelations about foreclosure documentation irregularities hit the housing markets. The transfer of a property’s title from the mortgagor (the homeowner) to the mortgagee (typically a bank or a trust) necessary for a successful fore-

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1 Taxpayers may also be at risk for losses related to Treasury’s investment in AIG. The Maiden Lane II and Maiden Lane III vehicles, which the Federal Reserve Bank of New York (FRBNY) created to hold assets purchased from AIG, hold substantial amounts of residential mortgage-backed securities (RMBSs), most of which are either sub-prime or Alt-A mortgages originated during the housing boom. Treasury’s ability to recover the funds it has put into AIG depends in significant part on FRBNY’s ability to collect on these investments, and uncertainty associated with the investments could hinder that process.
closure requires a series of steps established by state law. As further described below, depositions taken in a variety of cases in which homeowners were fighting foreclosure actions indicated that mortgage servicer employees—who were required to have personal knowledge of the matters to which they were attesting in their affidavits—were signing hundreds of these documents a day. Other documents appeared to have been backdated improperly and ineffectively or incorrectly notarized. While these documentation irregularities may sound minor, they have the potential to throw the foreclosure system—and possibly the mortgage loan system and housing market itself—into turmoil. At a minimum, in certain cases, signers of affidavits appear to have signed documents attesting to information that they did not verify and without a notary present. If this is the extent of the irregularities, then the issue may be limited to these signers and the foreclosure proceedings they were involved in, and in many cases, the irregularities may potentially be remedied by reviewing the documents more thoroughly and then resubmitting them. If, however, the problem is related not simply to a limited number of foreclosure documents but also to irregularities in the mortgage origination and pooling process, then the impact of the irregularities could be far broader, affecting a vast number of investors in the mortgage-backed securities (MBS) market, already completed foreclosures, and current homeowners. This latter scenario could result in extensive litigation, an extended freeze in the foreclosure market, and significant stress on bank balance sheets arising from the substantial repurchase liability that can arise from mistakes or misrepresentations in mortgage documents.

C. Timeline

After the housing market started to collapse in 2006, the effects rippled through the financial sector and led to disruptions in the credit markets in 2008 and 2009. In an economy that had been hit hard by the financial crisis and soon settled into a deep recession, the housing market declined, dragging down housing prices and increasing the likelihood of default. This put pressure on a variety of parties involved in the mortgage market. During the boom, there were many players involved in the process of lending, securitizing,
and servicing mortgages, and many of these players took on multiple roles.\textsuperscript{4}

The initial role of servicers was largely administrative.\textsuperscript{5} They were hired by the MBS investors to handle all back-office functions for existing loans, and generally acted as intermediaries between borrowers and MBS investors.\textsuperscript{6} However, when the housing bubble burst, and the number of delinquencies began to rise, the role of servicers evolved correspondingly.\textsuperscript{7} Servicer focus shifted from performing purely administrative tasks to engaging in active loss mitigation efforts.\textsuperscript{8} Servicers found themselves responsible for processing all defaults, modifications, short sales, and foreclosures.\textsuperscript{9} The servicers themselves have admitted that they were simply not prepared for the volume of work that the crisis generated.\textsuperscript{10} Thus, many servicers began subcontracting out much of their duties to so-called “foreclosure mills,” contractors that had significant incentives to move foreclosures along quickly.

Thus, as the boom in the housing market mutated into a boom in foreclosures,\textsuperscript{11} banks rushed to move delinquent borrowers out of their homes as quickly as possible, leading, apparently, to procedures of which the best that can be said is that they were sloppy and cursory. Concerns with foreclosure irregularities first arose when depositions of so-called “robo-signers” came to light.\textsuperscript{12} In a

\textsuperscript{4}For example, it was not uncommon for a commercial bank to perform both lending and servicing functions, and to have established separate lending and servicing arms of its organization. As discussed later in this report, the securitization process begins with a lender/originator, often but not always a commercial bank. Next, the mortgage is securitized by an investment bank. Finally, the mortgage is serviced, often also by a commercial bank or its subsidiary. Even where the same banks are listed as doing both lending and servicing, they did not necessarily service only the mortgages they originated. Source: Inside Mortgage Finance.


\textsuperscript{6}Servicer duties included fielding borrower inquiries, collecting mortgage payments from the borrowers, and remitting mortgage payments to the trust. See Id. at 157, 164. See also Congressional Oversight Panel, March Oversight Report: Foreclosure Crisis: Working Toward a Solution, at 40–42 (Mar. 6, 2009) (online at cop.senate.gov/documents/cop-030609-report.pdf) (hereinafter “March 2009 Oversight Report”).

\textsuperscript{7}See March 2009 Oversight Report, supra note 6, at 40.

\textsuperscript{8}See March 2009 Oversight Report, supra note 6, at 40–42. See also October 2010 SIGTARP Report, supra note 5, at 138.

\textsuperscript{9}See October 2010 SIGTARP Report, supra note 5, at 157–158. In the spring of 2009, when Treasury announced its Making Home Affordable program, the centerpiece of which was HAMP, servicers took on the additional responsibility of processing all HAMP modifications.

\textsuperscript{10}See March 2009 Oversight Report, supra note 6, at 39.

\textsuperscript{11}Mortgages that are more than 90 days past due are concentrated in certain regions and states of the country, including California, Nevada, Arizona, Florida, and Georgia. See Federal Reserve Bank of New York, Q3 Credit Conditions (Nov. 8, 2010) (online at www.newyorkfed.org/creditconditions/). Similarly, foreclosures are concentrated in certain states, including the so-called “sand states”: Arizona, California, Nevada, and Florida. U.S. Department of Housing and Urban Development, Report to Congress on the Root Causes of the Foreclosure Crisis, at vi (Jan. 2010) (online at www.huduser.org/Publications/PDF/Foreclosure09.pdf). The Panel’s field hearings in Clark County, Nevada, Prince George’s County, Maryland, and Philadelphia, Pennsylvania, also touched on the subject of high concentrations of foreclosures in those regions. See Congressional Oversight Panel, Clark County, NV: Ground Zero of the Housing and Financial Crisis (Dec. 16, 2008) (online at cop.senate.gov/hearings/library/hearing-121608-firsthearing.cfm); Congressional Oversight Panel, COP Hearing: Coping with the Foreclosure Crisis in Prince George’s County, Maryland (Feb. 27, 2009) (online at cop.senate.gov/hearings/library/hearing-022709-housing.cfm); Congressional Oversight Panel, Philadelphia Field Hearing on Mortgage Foreclosures (Sept. 24, 2009) (online at cop.senate.gov/hearings/library/hearing-092409-philadelphia.cfm).

\textsuperscript{12}The details of “robo-signers” actions surfaced on the Internet in September 2010, including video and transcriptions of depositions filed by robo-signers. See, e.g., The Florida Foreclosure Fraud Weblog, Jeffrey Stephan Affidavits ‘Withdrawn’ by Florida Default Law Group (Sept. 15, 2010) (online at floridaforeclosuresfraud.com/2010/09/jeffrey-stephan-affidavits-withdrawn-by-florida-default-law-group/). Some of this information was made public in court documents. For in-
June 7, 2010, deposition, Jeffrey Stephan, who worked for GMAC Mortgage as a “limited signing officer,” testified that he signed 400 documents each day. In at least some cases, he signed affidavits without reading them and without a notary present. He also testified that in doing so, he acted consistently with GMAC Mortgage’s policies. Similarly, faced with revelations that robo-signers had signed tens of thousands of foreclosure documents without actually verifying the information in them, Bank of America announced on October 8, 2010, that it would freeze foreclosure sales in all 50 states until it could investigate and address the irregularities. GMAC Mortgage took similar action, announcing that while it would not suspend foreclosures, it had “temporarily suspended evictions and post-foreclosure closings” in 23 states. In a state


GMAC Mortgage is a subsidiary of Ally Financial. The Panel examined Ally Financial, then named GMAC, in detail in its March 2010 report. See Congressional Oversight Panel, Oversight Report: The Unique Treatment of GMAC Under TARP (Mar. 11, 2010) (online at cop.senate.gov/documents/cop-031110-report.pdf). Federal National Mortgage Assoc. v. Nicole Bradbury supra note 12. There are two primary concerns with affidavits. First: are the affidavits accurate? For example, even if the homeowner is indebted, the amount of the indebtedness is a part of the attestation. The amount of the indebtedness must be accurate because there might be a subsequent deficiency judgment against the homeowner, which would require the homeowner to cover the remaining amount owed to the lender. And even if there was no deficiency judgment, an inflated claim would increase the recovery of the mortgage servicer from the foreclosure sale proceeds to the detriment of other parties in the process. Second, even if the information in the affidavit is correct, it must be sworn out by someone with personal knowledge of the indebtedness; otherwise it is hearsay and generally not admissible as evidence. See, e.g., Transcript of Court Proceedings, GMAC Mortgage, LLC v. Debbie Viscaro, et al., No. 07DI03804CI (Fla. Cir. Ct. Apr. 7, 2010) (online at floridaforeclosuresfraud.com/wp-content/uploads/2010/04/040710.pdf) (discussing whether affected affidavits were admissible). See generally Congressional Oversight Panel, Written Testimony of Katherine Porter, professor of law, University of Iowa College of Law, COP Hearing on TARP Foreclosure Mitigation Programs (Oct. 27, 2010) (online at cop.senate.gov/documents/testimony-102710-porter.pdf) (hereinafter “Written Testimony of Katherine Porter”).

Federal National Mortgage Assoc. v. Nicole Bradbury supra note 12. In addition, a Florida court admonished GMAC for similar problems in 2006. Plaintiff’s Notice of Compliance with this Court’s Order Dated May 1, 2006, TCIP BER 2 v. Leibowitz, No. 162004CA004835XXXXMA (June 14, 2006) (detailing GMAC’s policies on affidavits filed in foreclosure cases). These actions, if true, would be inconsistent with the usual documentation requirements necessary for proper processing of a foreclosure, giving rise to concerns that the foreclosure was not legally sufficient. See generally Written Testimony of Katherine Porter, supra note 14.

Bank of America Corporation, Statement from Bank of America Home Loans (Oct. 8, 2010) (online at mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1480657&highlight=) (hereinafter “Statement from Bank of America Home Loans”). At the same time, Bank of America agreed to indemnify Fidelity National Financial, a title insurer, for losses directly incurred by “failure to comply with state law or local practice on both transactions in which foreclosure has already occurred or been initiated and those to be initiated in the future.” See Fidelity National Financial, Fidelity National Financial, Inc., Reports EPS of 80.36 (Oct. 20, 2010) (online at files.shareholder.com/downloads/FNT/1051799117a0x411089209d61a9-8a05-454c-901d-4a78e0a7c4aeẾ

FNP. News 2010_10_20 Earnings.pdf). As further described below in Section D.2, title insurance is a critical piece of the mortgage market. Generally, title insurance insures against the possibility that title is encumbered or unclear, and thereby provides crucial certainty in transactions involving real estate. The insurance is retrospective—covering the history of the property until, but not after, the sale, and is issued after a review of the land title records. For a buyer, title insurance therefore insures against the possibility that a defect in the title that is not apparent from the public records will affect their ownership. Industry sources conversations with Panel staff (Nov. 9, 2010). A title insurer’s refusal to issue insurance can significantly hamper the orderly transfer of real estate and interests collateralized by real estate. Bank of America’s indemnity agreement with Fidelity National Financial shifts the risk of covered losses arising from the foreclosure irregularities from Fidelity National to Bank of America.

Twenty-two states require judicial oversight of foreclosure proceedings. In these judicial foreclosure states the mortgagee must establish its claim—show that a borrower is in default—before a judge. In non-judicial states a foreclosure can proceed upon adequate and timely notice
ment, it referred to the issue as a “procedural error . . . in certain affidavits” and stated that “we are confident that the processing errors did not result in any inappropriate foreclosures.” GMAC also announced that the company had taken three remedial steps to address the problem: additional education and training for employees, the release of a “more robust policy” to govern the process, and the hiring of additional staff to assist with foreclosure processing.18

These voluntary, privately determined suspensions were brief.19 On October 12, 2010, GMAC Mortgage released a statement indicating that in cases in which it had initiated a review process for its foreclosure procedures, it would resume foreclosure proceedings once any problems had been identified and, where necessary, addressed. It also noted that it “found no evidence to date of any inappropriate foreclosures.”20 On October 18, Bank of America announced that it had completed its review of irregularities in the 23 states that require judicial review of foreclosure proceedings and that it would begin processing foreclosure affidavits for 102,000 foreclosure proceedings in those states. It stated that it would review proceedings in the remaining 27 states on a case-by-case basis and that foreclosure sales in those states would be delayed until those reviews are complete. It further stated that in all states, it appeared that the “basis of our foreclosure decisions is accurate.”21

Various commentators, however, have questioned Bank of America’s ability to make such determinations in such a short timeframe.22 Then, on October 27, another large bank entered the fray when Wells Fargo announced that it had uncovered irregularities in its foreclosure processes and stated that it would submit supplemental affidavits in 55,000 foreclosure actions.23 Meanwhile, as the revelations of irregularities quickly multiplied, some argued that over and above the banks’ and servicers’ voluntary actions, the federal government should impose a nationwide
moratorium on foreclosures.24 Housing and Urban Development Secretary Shaun Donovan rejected the idea, arguing that “a national, blanket moratorium on all foreclosure sales would do far more harm than good.”25 At the same time, on October 13, attorneys general from all 50 states26 announced a bipartisan effort to look into the possibility that documents or affidavits were improperly submitted in their jurisdictions.

Although the public focus today lies generally on foreclosures, the possibility of document irregularities in mortgage transactions has expanded beyond their significance to foreclosure proceedings. Recently, investors have begun to claim that similar irregularities in origination and pooling of loans should trigger actions against entities in the mortgage origination, securitization, and servicing industries.27

D. Legal Consequences of Document Irregularities

The possible legal consequences of the documentation irregularities described above range from minor, curable title defects for certain foreclosed homes in certain states to more serious consequences such as the unenforceability of foreclosure claims and other ownership rights that rely on the ability to establish clear title to real property, forced put-backs of defective mortgages to originators, and market upheaval. The severity and likelihood of these various possible consequences depend on whether the irregularities are pervasive and when in the process they occurred.

Effective transfers of real estate depend on parties' being able to answer seemingly straightforward questions: who owns the property? how did they come to own it? can anyone make a competing claim to it? The irregularities have the potential to make these seemingly simple questions complex. As a threshold matter, a party seeking to enforce the rights associated with the mortgage must have standing in court, meaning that a party must have an interest in the property sufficient that a court will hear their claim and can provide them with relief.28 For a mortgage, “[a] mortgage may

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be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.”

Thus, the only party that may enforce the rights associated with the mortgage, with standing to take action on a mortgage in a court, must be legally able to act on the mortgage. Accordingly, standing is critical for a successful foreclosure, because if the party bringing the foreclosure does not have standing to enforce the rights attached to the mortgage and the note, that party may not be able to take the property with clear title that can be passed on to another buyer. Thus, if prior transfers of the mortgage were unsuccessful or improper, subsequent transfers of the property, such as a foreclosure or even an ordinary sale, could be affected. Further, failure to foreclose properly—whether because the foreclosing party did not actually hold the mortgage and the note, or because robo-signing affected the homeowner’s due process rights—means that the prior homeowner may be able to assert claims against a subsequent owner of the property. In this way, documentation irregularities can affect title to a property at a number of stages, as further described below.

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29 Restatement (Third) of Prop. (Mortgages) § 5.4(c) (1997). Only the proven mortgagee may maintain a foreclosure action. The requirement that a foreclosure action be brought only by the actual mortgagee is at the heart of the issues with foreclosure irregularities. If the homeowner or the court challenges the claim of the party bringing a foreclosure action that it is the mortgagee (and was when the foreclosure was filed), then evidentiary issues arise as to whether the party bringing the foreclosure can in fact prove that it is the mortgagee. The issues involved are highly complex areas of law, but despite the complexity of these issues, they should not be dismissed as mere technicalities. Rather, they are legal requirements that must be observed both as part of due process and as part of the contractual bargain made between borrowers and lenders.

30 That party must either own the mortgage and the note or be legally empowered to act on the owner’s behalf. Servicers acting on behalf of a trust or an originator do not own the mortgage, but by contract are granted the ability to act on behalf of the trust or the originator. See Federal Trade Commission, Facts for Consumers (online at www.ftc.gov/bcp/edu/pubs/consumer/homes/realt.htm) (accessed Nov. 12, 2010) (“In today’s market, loans and the rights to service them often are bought and sold. In many cases, the company that you send your payment to is not the company that owns your loan.”). See also October 2010 SIGTARP Report, supra note 5, at 160 (describing clients of servicers).

31 Laws governing the remedies available to a lender foreclosing on a property vary considerably. States also differ markedly in how long it takes the lender to foreclose depending on the available procedures. In general, claimants can seek to recover loan amounts by foreclosing on the property securing the debt. If the loan is “non-recourse,” the lender only may foreclose upon the property, but if the loan is “recourse,” the lender may foreclose upon the property and other borrower assets. Most states are recourse states. A loan in a recourse state allows a mortgagee to foreclose upon property securing a promissory note and, if that property is insufficient to discharge the debt, move against the borrower’s other assets. In non-recourse states, recovery of the loan amount is limited to the loan collateral. Put another way, the lender cannot go after the borrower’s other assets in a non-recourse state if the property is insufficient to discharge the debt. It is worth noting that even in recourse states, given the current economic climate, the mortgagors’ recourse to the borrower’s personal assets may be somewhat illusory since they may be minimal relative to the costs and delay in pursuing and collecting on a deficiency judgment. See Andra C. Ghent and Marianna Kudlyak, Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States, Federal Reserve Bank of Richmond Working Paper, No. 09–10, at 1–2 (July 7, 2009) (online at www.frb.org/webfiles/15051/website_gent.pdf).

32 Christopher Lewis Peterson, associate dean for academic affairs and professor of law, S.J. Quinney College of Law, University of Utah, conversations with Panel staff (Nov. 8, 2010).
1. Potential Flaws in the Recording and Transfer of Mortgages and Violations of Pooling and Servicing Agreements

a. Mortgage Recordation, Perfecting Title, and Transferring Title

i. Title

The U.S. real property market depends on a seller's ability to convey "clear title": an assurance that the purchaser owns the property free of encumbrances or competing claims. Laws governing title to land within its legal boundaries. Every county in the United States maintains records of who owns land there, of transfers of ownership, and of related mortgages or deeds of trust. While each state's laws have unique features, their basic requirements are the same, consistent with the notion that the purpose of the recording system is to establish certainty regarding property ownership. In order to protect ownership interests, fully executed, original (commonly referred to as "wet ink") documents must be recorded in a grantor/grantee index at a county recording office. In the case of a purchaser or transferee, a properly recorded deed describing both the property and the parties to the transfer establishes property ownership.

ii. Transfer

In a purchase of a home using a mortgage loan, required documents include (a) a promissory note establishing the mortgagor's personal liability, (b) a mortgage evidencing the security interest in the underlying collateral, and (c) if the mortgage is transferred, proper assignments of the mortgage and the note. There are two methods by which a promissory note may be transferred. First, it may be transferred by "negotiation," the signing over of individual promissory notes through indorsement, in the same way that a check can be transferred via indorsement. See UCC §§ 3–201, 3–203. The pooling and servicing agreements (PSAs) for securitized loans generally contemplate transfer through negotiation. Typical language in PSAs requires the delivery to the securitization trust of the notes and the mortgages, indorsed in blank. Alternatively, a promissory note may be transferred by a sale contract, also governed by whether a state has adopted particular revisions to the UCC. In many states, in order for a transfer to take place under the relevant portion of the UCC, there are only three requirements: the buyer of the promissory note must give value, there must be an authenticated document of sale that describes the promissory note, and the seller must have rights in the promissory note being sold. UCC § 9–203(a)-(b).
number of ways for a mortgage originator to proceed upon entering into a loan secured by real property. They may keep the loan on their own books; these are so-called “whole loans.” However, if the loan is sold in a secondary market—either as a whole loan or in a securitization process—the loan must be properly transferred to the purchaser. To be transferred properly, both the loan and accompanying documentation must be transferred to the purchaser, and the transfer must be recorded.

The first two requirements should be easily met in most securitizations; the transfer of the mortgage loans at each stage of the securitization involves the buyer giving the seller value and a document of sale (a mortgage purchase and sale agreement or a PSA) that should include a schedule identifying the promissory notes involved. The third requirement, however, that the seller must have rights in the promissory note being sold, is more complicated, as it requires an unbroken chain of title back to the loan’s originator. While the loan sale documents plus their schedules are evidence of such a chain of title, they cannot establish that the loan was not previously sold to another party.

Further, this discussion only addresses the validity of transfers between sellers and buyers of mortgage loans. It does not address the enforceability of those loans against homeowners, which requires physical possession of the original note. Thus, for both securitized and non-securitized loans, it is necessary for a party to show that it is entitled to enforce the promissory note (and therefore generally that it is a holder of the physical original note) in order to complete a foreclosure successfully.

Perhaps more critically, parties are free to contract around the UCC. UCC § 1–302. This raises the question of whether PSAs for MBS provide for a variance from the UCC by agreement of the parties. The PSA is the document that provides for the transfer of the mortgage and notes from the securitization sponsor to the depositor and thence to the trust. The PSA is also the document that creates the trust. The transfer from the originator to the sponsor is typically governed by a separate document, although sections of it may be incorporated by reference in the PSA.

If a PSA is considered a variation by agreement from the UCC, then there is a question of what the PSA itself requires to transfer the mortgage loans and whether those requirements have been met. In some cases, PSAs appear to require a complete chain of indorsements on the notes from originator up to the depositor, with a final indorsement in blank with the notes transferred thereafter as bearer paper, is important for establishing the “bankruptcy remoteness” of the trust assets. A critical part of securitization is to establish that the trust’s assets are bankruptcy remote, meaning that they could not be claimed by the bankruptcy estate of an upstream transferor of the assets. Without a complete chain of indorsements, it is difficult, if not impossible, to establish that the loans were in fact transferred from originator to sponsor to depositor to trust, rather than directly from originator or sponsor to the trust. If the transfer were directly from the originator or sponsor to the trust, the loans could possibly be claimed as part of the originator’s or sponsor’s bankruptcy estate. The questions about what the transfers required, therefore, involve both the question as to whether the required transfers actually happened, as well as whether, if they happened, they were legally sufficient.
iii. Mortgage Securitization Process

Securitizations of mortgages require multiple transfers, and, accordingly, multiple assignments. Mortgages that were securitized were originated through banks and mortgage brokers—mortgage originators. Next they were securitized by investment banks—the sponsors—through the use of special purpose vehicles, trusts that qualify for Real Estate Mortgage Investment Conduit (REMIC) status. These trusts are bankruptcy-remote, tax-exempt vehicles that pooled the mortgages transferred to them and sold interests in the income from those mortgages to investors in the form of shares. The pools were collateralized by the underlying real property, because a mortgage represents a first-lien security interest on an asset in the pool—a house.37 A governing document for securitizations called a pooling and servicing agreement (PSA) includes various representations and warranties for the underlying mortgages. It also describes the responsibilities of the trustee, who is responsible for holding the recorded mortgage documents, and of the servicer, who plays an administrative role, collecting and disbursing mortgage and related payments on behalf of the investors in the MBS.

As described above, in order to convey good title into the trust and provide the trust with both good title to the collateral and the income from the mortgages, each transfer in this process required particular steps.38 Most PSAs are governed by New York law and

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36 FBR Foreclosure Mania Conference Call, supra note 3.
37 For an overview of REMICs, see Federal National Mortgage Association, Basics of REMICs (June 16, 2009) (online at www.fanniemae.com/mbs/mbsbasics/remic/index.html). See also Internal Revenue Service, Final Regulations Relating to Real Estate Mortgage Investment Conduits, 26 CFR § 1 (Aug. 17, 1995) (online at www.irs.gov/pub/irs-regs/t8614.txt). Only the MBS investors are taxed on their income from the trusts’ payments on the MBS. REMICs are supposed to be passive entities. Accordingly, with few exceptions, a REMIC may not receive new assets after 90 days have passed since its creation, or there will be adverse tax consequences. Thus, if a transfer of a loan was not done correctly in the first place, proper transfer now could endanger the REMIC status. For an overview of residential mortgage-backed securities in general, see American Securitization Forum, ASF Securitization Institute: Residential Mortgage-Backed Securities (2006) (online at www.americansecuritization.com/uploadedFiles/RMBS%20Outline.pdf).
38 See Section D.1.a.ii, supra.
create trusts governed by New York law. New York trust law requires strict compliance with the trust documents; any transaction by the trust that is in contravention of the trust documents is void, meaning that the transfer cannot actually take place as a matter of law. Therefore, if the transfer for the notes and mortgages did not comply with the PSA, the transfer would be void, and the assets would not have been transferred to the trust. Moreover, in many cases the assets could not now be transferred to the trust. PSAs generally require that the loans transferred to the trust not be in default, which would prevent the transfer of any non-performing loans to the trust now. Furthermore, PSAs frequently have timeliness requirements regarding the transfer in order to ensure that the trusts qualify for favored tax treatment.

Various commentators have begun to ask whether the poor recordkeeping and error-filled work exhibited in foreclosure proceedings, described above, is likely to have marked earlier stages of the process as well. If so, the effect could be that rights were not properly transferred during the securitization process such that title to the mortgage and the note might rest with another party in the process other than the trust.

iv. MERS

In addition to the concerns with the securitization process described above, a method adopted by the mortgage securitization industry to track transfers of mortgage servicing rights has come under question. A mortgage does not need to be recorded to be enforceable as between the mortgagor and the mortgagee or subsequent transferee, but unless a mortgage is recorded, it does not provide the mortgagee or its subsequent transferee with priority over subsequent mortgagees or lien holders.

During the housing boom, multiple rapid transfers of mortgages to facilitate securitization made recordation of mortgages a more time-consuming, and expensive process than in the past. To alleviate the burden of recording every mortgage assignment, the mortgage securitization industry created the Mortgage Electronic Registration Systems, Inc. (MERS), a company that serves as the mortgagee of record in the county land records and runs a database that tracks ownership and servicing rights of mortgage loans. MERS created a proxy or online registry that would serve as the mortgagee of record in the county land records and runs a database that tracks ownership and servicing rights of mortgage loans.

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39 FBR Foreclosure Mania Conference Call, supra note 3.
40 N.Y. Est. Powers & Trusts Law § 7–2.4; FBR Foreclosure Mania Conference Call, supra note 3.
41 FBR Foreclosure Mania Conference Call, supra note 3.
43 See FBR Foreclosure Mania Conference Call, supra note 3.
44 See, e.g., FBR Foreclosure Mania Conference Call, supra note 3.
46 Christopher Lewis Peterson, associate dean for academic affairs and professor of law, S.J. Quinney College of Law, University of Utah, conversations with Panel staff (Nov. 8, 2010).
ferred from one MERS member to another. In essence, it attempted to create a paperless mortgage recording process overlying the traditional, paper-intense mortgage tracking system, in which MERS would have standing to initiate foreclosures.

MERS experienced rapid growth during the housing boom. Since its inception in 1995, 66 million mortgages have been registered in the MERS system and 33 million MERS-registered loans remain outstanding. During the summer of 2010, one expert estimated that MERS was involved in 60 percent of mortgage loans originated in the United States.

Widespread questions about the efficacy of the MERS model did not arise during the boom, when home prices were escalating and the incidence of foreclosures was minimal. But as foreclosures began to increase, and documentation irregularities surfaced in some cases and raised questions about a wide range of legal issues, including the legality of foreclosure proceedings in general and litigants raised questions about the validity of MERS. There is limited case law to provide direction, but some state courts have rendered verdicts on the issue. In Florida, for example, appellate courts have determined that MERS had standing to bring a foreclosure proceeding. On the other hand, in Vermont, a court determined that MERS did not have standing.

In the absence of more guidance from state courts, it is difficult to ascertain the impact of the use of MERS on the foreclosure process. The uncertainty is compounded by the fact that the issue is rooted in state law and lies in the hands of 50 states’ judges and legislatures. If states adopt the Florida model, then the issue is likely to have a limited effect. However, if more states adopt the

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50 MERS conversations with Panel staff (Nov. 10, 2010).


53 For instance, in a question-and-answer session during a recent earnings call with investors, Jamie Dimon, CEO and chairman of JPMorgan Chase, said that the firm had stopped using MERS “a while back.” JPMorgan Chase & Co., Q3 2010 Earnings Call Transcript (Oct. 13, 2010) (online at www.morningstar.com/earn-0/earnings/18244835-jp-morgan-chase-co-q3-2010.aspx.shtml) (hereinafter “Q3 2010 Earnings Call Transcript”). See also JPM on Foreclosures, MERS, supra note 3. This, however, related only to the use of MERS to foreclose.

54 MERS conversations with Panel staff (Nov. 10, 2010).

55 See generally Cincinnati Law Review Paper on Foreclosure, supra note 28. Cases addressed questions as to standing and as to whether, by separating the mortgage and the note, the mortgage had been rendered invalid (thus invalidating the security interest in the property). See A Survey of Cases Discussing MERS’ Authority to Act, supra note 48, at 20–21 (“These interpretive problems and inconsistencies have provoked some courts to determine the worst possible fate for secured loan buyers—that their mortgages were not effectively transferred or even that the mortgages have been separated from the note and are no longer enforceable. . . . Whether the MERS construct holds water is being robustly tested in a variety of contexts. Given the pervasiveness of MERS, if the construct is not viable, if MERS cannot file foreclosures, and, perhaps most importantly, cannot even record or execute an assignment of a mortgage, what then?”).


57 Mortg. Elec. Registry Sys. v. Johnston, No. 420–6–09 Rdcv (Rutland Superior Ct., Vt., Oct. 28, 2009) (determining that MERS did not have standing to initiate the foreclosure because the note and mortgage had been separated).
Vermont model, then the issue may complicate the ability of various players in the securitization process to enforce foreclosure liens. If sufficiently widespread, these complications could have a substantial effect on the mortgage market, inasmuch as it would destabilize or delegitimize a system that has been embedded in the mortgage market and used by multiple participants, both government and private. Although it is impossible to say at present what the ultimate result of litigation on MERS will be, holdings adverse to MERS could have significant consequences to the market.

If courts do adopt the Vermont view, it is possible that the impact may be mitigated if market participants devise a viable workaround. For example, according to a report released by Standard & Poor’s, “most” market participants believe that it may be possible to solve any MERS-related problems by taking the mortgage out of MERS and putting it in the mortgage owner’s name prior to initiating a foreclosure proceeding. According to one expert, the odds that the status of MERS will be settled quickly are low.

b. Violations of Representations and Warranties in the PSA

Residential mortgage-backed securities’ PSAs typically contain or incorporate a variety of representations and warranties. These representations and warranties cover such topics as the organization of the sponsor and depositor, the quality and status of the mortgage loans, and the validity of their transfers.

More particularly, PSAs, whose terms are unique to each MBS, include representations and warranties by the originator or seller relating to the conveyance of good title, documentation for the

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57 MERS was used by the most active participants in the securitization market including the largest banks (for example, Bank of America, JPMorgan Chase, Wells Fargo, Citigroup, and Fannie Mae and Freddie Mac), and processed 60 percent of all MBS. See MERSCORP, Inc., SunTrust Becomes Third Major Mortgage Provider in Recent Months to Require MERS System (Mar. 18, 2010) (online at www.mersinc.org/newsroom/press details.aspx?id=235). According to MERS, it has acted as the party foreclosing for one in five of the delinquent mortgages on its system. MERS conversations with Panel staff (Nov. 10, 2010).

58 See S&P on Foreclosure Crisis, supra note 17.

59 Christopher Lewis Peterson, associate dean for academic affairs and professor of law at the S.J. Quinney College of Law at the University of Utah, conversations with Panel staff (Nov. 8, 2010).

60 This section attempts to provide a general description of put-backs. Put-backs have been an issue throughout the financial crisis, typically in the context of questions about underwriting standards. See, e.g., Federal National Mortgage Association, Form 10-K for the Fiscal Year Ended December 31, 2009, at 9 (Feb. 26, 2010) (online at www.sec.gov/Archives/edgar/data/310522/000095012310018235/w77431e10vk.htm) (“As delinquencies have increased, we have accordingly increased our reviews of delinquent loans to uncover loans that do not meet our underwriting and eligibility requirements. As a result, we have increased the number of demands we make for lenders to repurchase these loans or compensate us for losses sustained on the loans, as well as requests for repurchase or compensation for loans for which the mortgage insurer rescinds coverage.”). Documentation irregularities may provide an additional basis for put-backs, although the viability of these put-back claims will depend on a variety of deal-specific issues, such as the particular representations and warranties that were incorporated into the PSA, which in turn are related to whether the MBSs are agency or private-label securities. Although private-label MBS PSAs typically included weaker representations regarding the quality of the loans and underwriting, they still contain representations regarding proper transfer of the documents to the trust.

61 Failure to transfer the loans properly would create two sources of liability: one would be in rendering the owner of the mortgage and the note uncertain, and the other would be a breach of contract claim under the PSA. For an example of typical language in representations and warranties contained in PSAs or incorporated by reference from mortgage loan purchase agreements executed by the mortgage originator, see Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42 (“...and that immediately prior to the transfer and assignment...”) Continued
loan, underwriting standards, compliance with applicable law, and delivery of mortgage files, among other things. In addition, the mortgage files must contain specific loan and mortgage documents and notification of material breaches of any representations and warranties.

If any of the representations or warranties are breached, and the breach materially and adversely affects the value of a loan, which can be as simple as reducing its market value, the offending loan is to be “put-back” to the sponsor, meaning that the sponsor is required to repurchase the loan for the outstanding principal balance plus any accrued interest.67

If successfully exercised, these put-back clauses have enormous value for investors, because they permit the holder of a security with (at present) little value to attempt to recoup some of the lost value from the originator (or, if the originator is out of business, the sponsor or a successor). Put-backs shift credit risk from MBS investors to MBS sponsors (typically, as noted above, investment banks): the sponsor now has the defective loan on its balance sheet, and the trust has cash for the full unpaid principal balance of the loan plus accrued interest on its balance sheet.68 This means that...

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62 See Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42 (“Each Mortgage Note, each Mortgage, each Assignment and any other document required to be delivered by or on behalf of the Seller under this Agreement or the Pooling and Servicing Agreement to the Purchaser or any assignee, transferee or designee of the Purchaser for each Mortgage Loan has been or will be delivered to the Purchaser or any such assignee, transferee or designee. With respect to each Mortgage Loan, the Seller is in possession of a complete Mortgage File in compliance with the Pooling and Servicing Agreement . . . . The Mortgage Note and the related Mortgage are genuine, and each is the legal, valid and binding obligation of the Mortgagor enforceable against the Mortgagor by the mortgagee or its representative in accordance with its terms, except only as such enforcement may be limited by bankruptcy, insolvency . . . .”). These representations and warranties generally state that the documents submitted for loan underwriting were not falsified and contain no untrue statement of material fact or omit to state a material fact required to be stated therein and are not misleading and that no error, omission, misrepresentation, negligence, or fraud occurred in the loan’s origination or insurance.

63 See Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42 (“Each Mortgage Loan was underwritten in accordance with the Seller’s underwriting guidelines as described in the Prospectus Supplement as applicable to its credit grade in all material respects.”). Many concerns over underwriting standards have surfaced in the wake of the housing boom, such as lack of adequate documentation, lack of income verification, misrepresentation of income and job status, and haphazard appraisals. Even before the more recent emergence of the issue of document irregularities, institutions were pursuing put-back actions to address concerns over underwriting quality. See, for example, Federal National Mortgage Association, Form 10-Q for the Quarterly Period Ended June 30, 2010, at 95 (Aug. 5, 2010) (online at www.sec.gov/Archives/edgar/data/310522/000095012310073427/w79360e10q.htm) (“Our mortgage seller/servicers are obligated to repurchase loans or foreclosed properties, or reimburse us for losses if the foreclosed property has been sold, if it is determined that the mortgage loan did not meet our underwriting or eligibility requirements or if mortgage insurers rescind coverage.”)

64 See Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42 (“Each Mortgage Loan at origination complied in all material respects with applicable local, state and federal laws, including, without limitation, predatory and abusive lending, usury, equal credit opportunity, real estate settlement procedures, truth-in-lending and disclosure laws, and summation of the transactions contemplated hereby, including without limitation the receipt of interest does not involve the violation of any such laws.”).

65 See Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42.

66 For examples of representations and warranties, see New Century Home Equity Loan Trust, Form 8-K for the Period Ending February 16, 2005, at Ex. 99.2 (Mar. 11, 2005) (online at www.secinfo.com/dqTk5t2Ey_a.htm#hm88).

67 See, e.g., Citigroup, Inc., Form 10-K for the Fiscal Year Ended December 31, 2009, at 131 (Feb. 26, 2010) (online at www.sec.gov/Archives/edgar/data/831001/000120677410000406/cit110k.htm) (hereinafter “Citigroup Form 10-K”). However, since every deal is different, there are a number of different methods for extinguishing a repurchase claim that may not necessarily require the actual repurchasing of the loan. Industry experts conversations with Panel staff (Nov. 9, 2010).

68 See Citigroup Form 10-K, supra note 67, at 131.
the sponsor may have to increase its risk-based capital and will bear the risk of future losses on the loan, while the trust receives 100 cents on the dollar for the loan.69 Not surprisingly, put-back actions are very fact-specific and can be hotly contested.70

Servicers do not often pursue representation and warranty violations. A 2010 study by Amherst Mortgage Securities showed that while private mortgage insurers were rescinding coverage on a substantial percentage of the loans they insured because of violations of very similar representation and warranties, there was very little put-back activity by servicers, even though one would expect relatively similar rates.71 One explanation for the apparent lack of servicer put-back activity may be the possibility of servicer conflicts of interest. Servicers are often affiliated with securitization sponsors and therefore have disincentives to pursue representation and warranty violations. Trustees have disincentives to remove servicers because they act as backup servicers and bear the costs of servicing if the servicer is terminated from the deal. Finally, investors are poorly situated to monitor servicers. Whereas a securitization trustee could gain access to individual loan files—but typically do not—investors cannot review loan files without substantial collective costs.73 On the other hand, investor lawsuits have the potential to be lucrative for lawyers, so it is possible that some investor groups may take action despite their limited access to information.74

2. Possible Legal Consequences of the Document Irregularities to Various Parties

In addition to fraud claims, discussed further below, and claims arising from whether the loans in the pool met the underwriting standards required (which is primarily relevant to investors’ rights of put-back and bank liability), the other primary concern arising out of document irregularities is the potential failure to convey
clear title to the property and ownership of the mortgage and the note.

There are two separate but interrelated forms of conveyance that may be implicated by documentation irregularities: conveyance of the mortgage and the note, and conveyance of the property securing the mortgage. The foreclosure documentation irregularities affect conveyance of the property: if the foreclosure was not done correctly, the bank or a subsequent buyer may not have clear title to the property. But these foreclosure irregularities may also be further compromised by a failure to convey the mortgage and the note properly earlier in the process. If, during the securitization process, required documentation was incomplete or improper, then ownership of the mortgage may not have been conveyed to the trust. This could have implications for the PSA—inasmuch as it would violate any requirement that the trust own the mortgages and the notes—as well as call into question the holdings of the trust and the collateral underlying the pools under common law, the UCC, and trust law.75 The trust in this situation may be unable to enforce the lien through foreclosure because only the owner of the mortgage and the note has the right to foreclose. If the owner of the mortgage is in dispute, no one may be able to foreclose until ownership is clearly established.

If it is unclear who owns the mortgage, clear title to the property itself cannot be conveyed. If, for example, the trust were to enforce the lien and foreclose on the property, a buyer could not be sure that the purchase of the foreclosed house was proper if the trust did not have the right to foreclose on the house in the first place. Similarly, if the house is sold, but it is unclear who owns the mortgage and the note and, thus, the debt is not properly discharged and the lien released, a subsequent buyer may find that there are other claimants to the property. In this way, the consequences of foreclosure documentation irregularities converge with the consequences of securitization documentation irregularities: in either situation, a subsequent buyer or lender may have unclear rights in the property.

These irregularities may have significant bearing on many of the participants in the mortgage securitization process:

- **Parties to Whom a Mortgage and Note Is Transferred**—
  If a lien was not “perfected”—filed according to appropriate procedures—participants in the transfer process may no longer have a first-lien interest in the property and may be unable to enforce that against third-parties (and, where the property has little value, particularly in non-recourse jurisdictions, may not be able to recover any money). Similarly, if the notes and mortgages were not properly transferred, then the party that can enforce the rights attached to the note and the mortgage—right to receive payment and right to foreclose, among others—may not be readily identifiable. If a trust does not have proper

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75 Most PSAs are governed by New York trust law and contain provisions that override UCC Article 9 provisions on secured transactions. This report does not attempt to describe every possible legal defect that may arise out of the irregularities, particularly given the rapidly developing nature of the problem, but addresses arguments common to the current discussions. In addition, the Panel takes no position on whether any of these arguments are valid or likely to succeed.
ownership to the notes and the mortgage, it is unclear what assets are actually in the trust, if any.\textsuperscript{76}

- **Sponsors, Servicers, and Trustees**—Failure to follow representations and warranties found in PSAs can lead to the removal of servicers or trustees and trigger indemnification rights between the parties.\textsuperscript{77} Failure to record mortgages can result in the trust losing its first-lien priority on the property. Failure to transfer mortgages and notes properly to the trust can affect the holdings of the trust. If transfers were not done correctly in the first place and cannot be corrected, there is a profound implication for mortgage securitizations: it would mean that the improperly transferred loans are not trust assets and MBS are in fact not backed by some or all of the mortgages that are supposed to be backing them. This would mean that the trusts would have litigation claims against the securitization sponsors for refunds of the value given by the trusts to the sponsors (or depositors) as part of the securitization transaction.\textsuperscript{78} If successful, in the most extreme scenario this would mean that MBS trusts (and thus MBS investors) could receive complete recoveries on all improperly transferred mortgages, thereby shifting the losses to the securitization sponsors.\textsuperscript{79} Successful put-backs to these entities would require them to hold those loans on their books. Even if the mortgage loans are still valid, enforceable obligations, the sponsors would (if regulated for capital adequacy) be required to hold capital against the mortgage loans, and might have to raise capital. If these banks were unable to raise cap-

\textsuperscript{76} The competing claims about MERS can also factor into these issues. If MERS is held not to be a valid recording system, then mortgages recorded in the name of MERS may not have first priority. Similarly, if MERS does not have standing to foreclose, it could cast into question foreclosures done by MERS.

\textsuperscript{77} It should be noted that while no claims have been made yet based on an alleged breach of representations and warranties related to the transfer of title, claims have been made based on allegations of poor underwriting and loan pool quality. See Buckingham Research Group, Conference Takeaways on Mortgage Repurchase Risk, at 2 (Nov. 4, 2010) (hereinafter “Buckingham Research Group Conference Takeaways”). However, there is a possibility that there will be put-back demands for breaches of representations and warranties relating to mortgage transfers.

\textsuperscript{78} Because the REMIC status and avoidance of double taxation (trust level and investor level) is so critical to the economics of securitization deals, the PSAs that govern the securitization trusts are replete with instructions to servicers and trustees to protect the REMIC status, including provisions requiring that the transfers of the mortgage loans occur within a limited time after the trust’s creation. See, e.g., Agreement Among Deutsche Alt-A Securities, Inc., Depositor, Wells Fargo Bank, National Association, Master Servicer and Securities Administrator, and HSBC Bank USA, National Association, Trustee, Pooling and Servicing Agreement (Sept. 1, 2006) (online at www.secinfo.com/d13d21.v1B7.d.htm#1stPage).

\textsuperscript{79} If a significant number of loan transfers failed to comply with governing PSAs, it would mean that sizeable losses on mortgages would rest on a handful of large banks, rather than being spread among MBS investors. Sometimes the securitization sponsor is indemnified by the originator for any losses the sponsor incurs as a result of the breach of representations and warranties. See Id. at section 10.03. This indemnification is only valuable, however, to the extent that the originator has sufficient assets to cover the indemnification. Many originators are thinly capitalized and others have ceased operating or filed for bankruptcy. Therefore, in many cases, any put-back liability is likely to rest on the securitization sponsors. Although these put-back rights sometimes entitle the trust only to the value of the loan less any payments already received, plus interest, the value the trust would receive is still greater than the current value of many of these loans. As a number of originators and sponsors were acquired by other major financial institutions during 2008–2009, put-back liability has become even more focused on a relatively small number of systemically important financial institutions. Financial Crisis Inquiry Commission, Preliminary Staff Report: Securitization and the Mortgage Crisis, at 13 (Apr. 1, 2010) (online at www.fcic.gov/reports/pdfs/2010-0407-Preliminary_Staff_Report.-Securitization_and_the_Mortgage_Crisis.pdf) (table showing that five of the top 25 sponsors in 2007 have since been acquired). Overall, recovery is likely to be determined on a deal-by-deal basis.
As noted above, the servicer does not own the mortgage and the note, but has a contractual ability to enforce the legal rights associated with the mortgage and the note. In addition, they may defend themselves against foreclosure proceedings on the claim that robo-signing irregularities deprived them of due process.

82 See Section E.1, infra.

The majority of PSAs were created under the laws of New York state. Under New York law, there are four requirements for creating a trust: (1) a designated beneficiary; (2) a designated trustee; (3) property sufficiently identified; and (4) and the delivery of the property to the trustee. Joshua Rosner of Graham Fisher, an investment research firm, has noted that there may not have always been proper delivery of the property to the trustee. In New York it is not enough to have an intention to deliver the property to the trust, the property must actually be delivered. So, what defines acceptable delivery? The answer appears to lie with the ‘governing...
provide substantial grounds for widespread put-backs. Moreover, this type of litigation could be extremely lucrative for the lawyers representing the investors. It may be expected that, for this type of action, the investors’ counsel would have strong incentives to litigate forcefully.

- **Title Insurance Companies**—In the United States, purchasers of real property (i.e., land and/or buildings) typically purchase title insurance, which provides a payment to the purchaser if a defect in the title or undisclosed lien is discovered after the sale of the property is complete. Given the potential legal issues discussed in this section, title insurance companies could face an increase in claims in the near future. The threat of such issues may also lead insurers to require additional documentation before issuing a policy, increasing the costs associated with buying property.84

- **Junior Lien Holders**—Second and third liens are not as commonly securitized as first liens; therefore, their holders may not face the same direct risk as first lien holders. Junior lien holders may, however, face an indirect risk if the rights of the first lien holder cannot be properly established. If the property securing the lien is sold, all senior liens must be paid first. If the senior liens cannot be paid off because it is impossible to determine who holds those liens, the junior lien holder may not be able to claim any of the proceeds of the sale until the identity of the senior lien holder is settled. On the other hand, document irregularities may offer a windfall for some junior liens. If the first mortgage has not been perfected, the first lien holder loses its priority over any other, perfected liens. Therefore, if a second lien was properly recorded, it could take priority over a first lien that was not properly recorded. The majority of second liens, however, were completed using the same system as first liens and therefore face the same potential issues. Moreover, many mortgages that were created during the housing boom were created with an 80 percent/20 percent “piggy-back” structure in which a first and second lien were created simultaneously and using the same system. If neither lien was perfected, there may be a question as to which would take priority over the other.85

- **Local Actions**—Despite the state attorneys’ general national approach to investigating document irregularities, there may

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84 Although title insurers appear to be poised for potential risk, one observer has noted that title insurance lobbyists and trade groups have instead played down the possible effects of these legal issues. Christopher Lewis Peterson, professor of law, S.J. Quinney School of Law, University of Utah, conversations with Panel staff (Nov. 8, 2010). Title insurers state that they do not presently believe that these legal issues will have much effect. Industry sources conversations with Panel staff (Nov. 10, 2010). Professor Peterson suggested that the insurers may earn sufficient remuneration from various fees to offset any potential risk. On the other hand, title insurers could stand to suffer significant losses if some of the matters presently discussed in the market, such as widespread invalidation of MERS, come to pass. It is too soon to say if such events are likely, but title insurers would be one of the primary parties damaged by such an action.

85 Christopher Lewis Peterson, professor of law, S.J. Quinney School of Law, University of Utah, conversations with Panel staff (Nov. 8, 2010). If the mortgages were created at different times, the mortgage created first would take precedence.
be separate state initiatives. Under traditional mortgage recording practices, each time a mortgage is transferred from a seller to a buyer, the transfer must be recorded and a fee paid to the local government. Although each fee is not large—typically around $30—the fees for the rapid transfers inherent in the mortgage securitization process could easily add up to hundreds of dollars per securitization. The MERS system was intended in part to bypass these fees.86 Local jurisdictions, deprived of mortgage recording tax revenue, may file lawsuits against originators, servicers, and MERS.

The primary private litigation in this area is likely to come from investors in MBS. These investors are often institutional investors, a group that has the resources and expertise to pursue such claims.87 A major obstacle to investor lawsuits seeking put-backs has been a provision in PSAs that limits private investor action in the case of breaches of representations and warranties to certificate holders with some minimum percentage of voting rights, often 25 percent.88 Investors also suffer from a collective-action problem in trying to achieve these thresholds, not least because they do not know who the other investors are in a particular deal, and many investors are reluctant to share information about their holdings. Furthermore, the interests of junior and senior tranche holders may not be aligned.89

When investors do achieve the collective-action threshold, it is only the first step in a complicated process. For example, if the trustee declines to declare the servicer in default, then investors can either bring suit against the trustee to force it to remove the servicer, attempt to remove the trustee (which often requires a 51 percent voting threshold), or remove the servicer directly (with a two-thirds voting threshold). It bears emphasis that the collective-action thresholds required vary from deal to deal. Two recent investor lawsuits started with a view to enforce put-back provisions resulted in dismissals based on the plaintiffs’ failure to adhere to 25-percent threshold requirements.90 The practical effect of such decisions is that the hurdle of meeting this relatively high threshold of certificate holders can limit investors’ ability to examine the documents that would support their claims.

Recently, however, investors are beginning to take collective action, suggesting that the 25-percent threshold may not be an enormous burden for organized investors. A registry created by RMBS Clearing House is providing a confidential data bank whose purpose is to identify and organize certificate holders into groups that can meet threshold requirements.91 Using the registry data, a law-
suit has been initiated against JPMorgan Chase and the Federal Deposit Insurance Corporation (FDIC), both of which have assumed liabilities of failed bank Washington Mutual, seeking to enforce put-backs and document disclosure. Recently, an investor group composed of eight institutional investors, including the Federal Reserve Bank of New York (FRBNY), representing more than 25 percent of the voting rights in certain Countrywide MBSs, made a request of securitization trustee Bank of New York to initiate an investigation of the offerings originated by Countrywide prior to its acquisition by Bank of America. After Bank of New York refused to act, the group petitioned Bank of America directly in an effort to review the loan files in the pool. Some believe that the difficulty faced by investors in gaining access to the loan files that support their claims of contractual breaches and the cost of auditing them will make widespread litigation economically unrealistic. Even as put-back demands from investors are appearing, unless the investors can review loan documents, they lack the information to know what level of put-backs should be occurring. Moreover, at least one bank CEO has stated that his bank will challenge any determination that underwriting standards were not met on a loan-by-loan basis, creating further hurdles. At present, it is unclear what litigation risk these proceedings are likely to pose for the banks. There is good reason to assume, however, that the litigation will attract sophisticated parties interested in the deep pockets of the sponsors.

Given the complexity of the legal issues, the numerous parties involved, and the relationships between many of them, it is likely

more than 50 percent of holders of 900 mortgage-backed securities, and more than 66 percent of the holders of 450 mortgage-backed securities representing, in the aggregate, a face amount of $500 billion, or approximately one-third of the private label mortgage-backed securities market. One industry participant likened them to a dating site for investors. RMBS Clearing House conversations with Panel staff (Oct. 24, 2010).

92 See Deutsche Bank v. Federal Deposit Insurance Corporation, supra note 42.
93 Gibbs & Bruns represents eight institutional investors who collectively hold more than 25 percent of the voting rights in more than $47 billion in Countrywide mortgage-backed securities issued in 115 offerings in 2006 and 2007. On Oct 20, 2010, FRBNY became a signatory to the letter.
94 Under the PSA, the trustee is entitled to a satisfactory indemnity prior to allowing such a process to continue. The trustee for the securities, Bank of New York, did not find the indemnity offered acceptable and refused to allow the parties to proceed. The various trustees for these securities may therefore form an additional barrier between investors and review of the loan files. For example, Fannie Mae explains in a prospectus for mortgage-backed securities (REMIC certificates) that, “We are not required, in our capacity as trustee, to risk our funds or incur any liability if we do not believe those funds are recoverable or if we do not believe adequate indemnity exists against a particular risk.” See Federal National Mortgage Association, Single-Family REMIC Prospectus, at 44 (May 1, 2010) (online at www.efanniemae.com/syndicated/documents/mbs/remicpros/SF FM_May 1_2010.pdf).
95 Letter from Gibbs & Bruns LLP on behalf of BlackRock Financial Management, Inc. et al. to Countrywide Home Loans Servicing LP, The Bank of New York, and counsel, Re: Holders’ Notice to Trustee and Master Servicer (Oct. 18, 2010) (hereinafter “Letter from Gibbs & Bruns LLP to Countrywide”). The group including FRBNY alleges generally that the loans in the pools did not meet the quality required by the PSA and have not been prudently serviced.
96 Jamie Dimon, CEO of JPMorgan Chase, commented during a recent quarterly earnings call that litigation costs in foreclosure cases will be so large as to become a cost of doing business and that, in anticipation of such suits JPMorgan Chase has raised its reserves by $1.3 billion. Transcript provided by SNL Financial (Nov. 3, 2010). See also JPM on Foreclosures, MERS, supra note 3.
97 Chuck Noski, chief financial officer for Bank of America, stated during an earnings call for the third quarter of 2010: “This really gets down to a loan-by-loan determination and we have, we believe, the resources to deploy against that kind of a review.” Bank of America Corporation, Q3 2010 Earnings Call Transcript (Oct. 19, 2010) (online at www.morningstar.com/earnings/18372176-bank-of-america-corporation-q3-2010.aspx?index=1) (hereinafter “Bank of America Q3 2010 Earnings Call Transcript”).
98 For a discussion of litigation risk, see Section F.2, infra.
that any litigation will be robust, costly, and lengthy. Nonetheless, it is possible that banks may see a financial advantage to delaying put-backs through litigation and other procedural hurdles, if only to slow the pace at which they must be completed and to keep the loans off of their books a little longer. In addition, as discussed above, conflicts of interest in the industry may further complicate an assessment of litigation risk: Servicers, trustees, sponsors, and originators are often affiliated with each other, meaning that each has a disincentive to proceed with an action against another lest it harm its own bottom line. Moreover, there is the possibility that those who foresee favorable results from such litigation, and who have the resources and stamina for complex litigation (such as hedge funds), will purchase affected assets with the intent to participate as plaintiffs, intensifying the legal battle further. TARP recipients, of course, were and are at the center of many of these transactions, and predicting all of the possible litigation to which they might be subject as a result of the irregularities (known and suspected) is virtually impossible. It is not unlikely that, on the heels of highly publicized actions initiated by major financial institutions and the increasing likelihood that investors can meet the 25 percent threshold requirements for filing lawsuits, sophisticated institutional investors may become more interested in pursuing litigation or even in investing in MBS in order to position themselves for lawsuits. Some security holders, such as large endowments and pension plans, have fiduciary duties to their own investors that may lead them to try and enforce repurchase rights. In addition, if investors such as hedge funds that have the resources to support protracted litigation initiate lawsuits, that could intensify the legal battles that banks will face. If litigation based on significant document irregularities is successful, it may throw the large banks back into turmoil.

Similarly, Fannie Mae and Freddie Mac may become embroiled in the controversies. Fannie and Freddie have already been actively engaged in efforts to put-back nonconforming loans to the originators/sponsors of the loans they guarantee. But they may also find themselves on the other side, as targets of litigation. In addition to being embedded in the entire securitization process, they are part owners of MERS, which is becoming a litigation target.

See Section D.1.b, supra.

See discussion of collective action thresholds in this section, supra.

In its latest filing with the Securities and Exchange Commission (SEC), Citigroup acknowledged that hedge fund Cambridge Place Investment Management, The Charles Schwab Corporation, the Federal Home Loan Bank of Chicago, and the Federal Home Loan Bank of Indianapolis have filed actions related to underwriting irregularities in RMBS. See Citigroup, Inc., Form 10-Q for the Quarterly Period Ended September 30, 2010, at 294 (Nov. 5, 2010) (online at www.sec.gov/Archives/edgar/data/831001/000104746910009274/a2200785z10-q.htm) (hereinafter "Citigroup 10-Q for Q2 2010"). In addition, the hedge fund community has begun coalescing around their investments in RMBS, forming a lobbying group called the Mortgage Investors Coalition.

Shareholders played a critical role in the development of MERS. Through their capital support, MERS was able to fund expenses related to development and initial start-up. See also Letter from R.K. Arnold, president and chief executive officer, MERSCORP, Inc., to Elizabeth M. Murphy, secretary, Securities and Exchange Commission, Comments on the Commission’s Proposed Rule for Asset-Backed Securities, at Appendix B (July 30, 2010) (online at www.sec.gov/comments/s7-08-10/s70810-58.pdf) (attaching as an Appendix letters from both Fannie Mae and Freddie Mac, which include the Fannie Mae statement...
Both Fannie and Freddie have recently ceased allowing MERS to bring foreclosure actions.103 Further, Fannie and Freddie used at least one of the law firms implicated in the irregularities to handle foreclosures.104 Given that these two government-supported firms are perceived as the ultimate “deep pocket,” it is likely that interested litigants will attempt to find a way to attach liability to them, which, if successful, could further affect the taxpayers.105

3. Additional Considerations

The participants described above are by no means the only parties affected by these issues. Lenders may be reluctant to make new loans on homes that could have title issues. Investors may likewise be reluctant to invest in mortgages and MBS that may be affected. Uncertainty about the actions that federal and state governments may take to address the documentation issues, how these actions will affect investment returns, and concerns that these problems may be widespread in the mortgage industry may also discourage investors. Until there is more clarity on the legal issues surrounding title to affected properties, as well as on the extent of any title transfer issues, it may also become more difficult or expensive to get title insurance, an essential part of any real estate transaction. In addition, put-backs of mortgages, damages from lawsuits, and claims against title companies, mortgage servicers, and MBS pooling and securitization firms have the potential to drive these firms out of business. Should these and other compa-

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104 On November 2, 2010, Fannie Mae and Freddie Mac terminated their relationships with a Florida foreclosure attorney David J. Stern, who had processed thousands of evictions on their behalf and faces allegations by the Florida Attorney General’s office of improper foreclosure practices including false and misleading documents. See Office of Florida Attorney General Bill McCollum, Florida Law Firms Subpoenaed Over Foreclosure Filing Practices (Aug. 10, 2010) (online at www.myfloridalegal.com/newsrel/newsreleases/2BAC1AFA261BBB98S57577BB001BB30); Office of Florida Attorney General Bill McCollum, Active Public Consumer-Related Investigation, No. L10–3–1145 (online at www.myfloridalegal.com/newsrel/newsreleases/AD0F010A43782D96852577770967B68D?Open&Highlight=0,david, stern) (accessed Nov. 10, 2010); Nick Timiraos, Fannie, Freddie Cut Ties to Law Firm, Wall Street Journal (Nov. 3, 2010) (online at online.wsj.com/article/SB100014240527487044627945559034258798742.html) (“A spokeswoman for Freddie Mac, Sharon McHale, said it took the rare step on Monday of beginning to remove loan files after an internal review raised concerns about some of the practices at the Stern firm. She added that Freddie Mac took possession of its files ‘to protect our interest in those loans as well as those of borrowers.’”)

105 The Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac into conservatorship on September 7, 2008, in order to preserve each company’s assets and to restore them to sound and solvent condition. Treasury has guaranteed their debts, and FHFA has all the powers of the management, board, and shareholders of the GSEs. House Financial Services, Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, Written Testimony of Edward J. DeMarco, acting director, Federal Housing Finance Agency, The Future of Housing Finance: A Progress Update on the GSEs, at 2 (Sept. 15, 2010) (online at financialservices.house.gov/Media/file/hearings/111/DeMarcos091510.pdf). One of the questions that has arisen is whether there are likely to be differences in the quality of securitization processing for government-sponsored entity (GSE) MBS compared to private-label MBS. Some industry sources believe that the process underlying GSE securitizations is likely to have been more rigorous, but it is presently impossible to determine if this is correct, and, accordingly, this report does not attempt to distinguish between GSE and private-label deals. However, if GSE securitizations prove to have been done improperly, it might result in additional litigation for the GSEs—either as targets, or as the GSEs try to pursue indemnification rights.
cies that provide services to the mortgage market either decide to exit the market or go bankrupt, and no other companies opt to take their place in the current environment, the housing market would likely suffer. Even the mere possibility of such losses in the future could have a chilling effect on the risk tolerance of these firms, and could dim the housing market expectations of prospective home buyers and mortgage investors, further reducing housing demand and raising the cost of mortgages.\textsuperscript{106}

More generally, however, and as noted below, the efficient functioning of the housing market is highly dependent on the existence of clear property rights and a level of trust that various market participants have in each other and in the integrity of the market system.\textsuperscript{107} If the current foreclosure irregularities prove to be widespread, they have the potential to undermine trust in the legitimacy of many foreclosures and hence in the legality of title on many foreclosed properties.\textsuperscript{108} In that case, it is possible that buyers will avoid purchasing properties in foreclosure proceedings because they cannot be sure that they are purchasing a clean title. Protections in the law, such as those for a bona-fide purchaser for value, may not ease their anxiety if they are concerned that they will become embroiled in litigation when prior owners appeal foreclosure rulings. These concerns would be likely to continue until the situation is resolved, or at least until the legal issues surrounding title to foreclosed properties have been clarified. Those buyers who remain will likely face less competition and will offer very low bids. Even foreclosed homes that have already been sold are at risk, since homes sold before these documentation issues came to light cannot be assumed to have a legally provable chain of title. These homes will therefore likely be difficult to resell, except at low prices that attract risk-tolerant buyers.

\textbf{E. Court Cases and Litigation}

The foreclosure documentation irregularities unquestionably show a system riddled with errors. But the question arises: Were they merely sloppy mistakes, or were they fraudulent? Differing answers to this question may not affect certain remedies available to aggrieved parties—put-backs, for example, are available for both mistakes and for fraud—but would affect potential damages in a lawsuit.\textsuperscript{109} It is important to note that the various parties who may


\textsuperscript{107} Hernando de Soto, The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else, at 5–6, 174 (2000) (“Formal property titles allowed people to move the fruits of their labor from a small range of validation into that of an expanded market.”).

\textsuperscript{108} The foreclosed homes where a single bank originated the mortgage, serviced it, held it as a whole loan, and processed the foreclosure documents themselves are very unlikely to be affected. The effect of the irregularities on other types of loans and homes are, as discussed in this report, presently very difficult to predict.

\textsuperscript{109} See, e.g., Agreement Among Deutsche Alt-A Securities, Inc., Depositor, Wells Fargo Bank, National Association, Master Servicer and Securities Administrator, and HSBC Bank USA, National Association, Trustee, Pooling and Servicing Agreement (Sept. 1, 2006) (online at www.secinfo.com/d13f21.v1B7.d.htm) (“Section 2.03: Repurchase or Substitution of Loans. (a) Upon discovery or receipt of notice . . . of a breach by the Seller of any representation, warranty or covenant under the Mortgage Loan Purchase Agreement . . . the Trustee shall enforce the obligations of the Seller under the Mortgage Loan Purchase Agreement to repurchase such Loan’’); Trust Agreement Between GS Mortgage Securities Corp., Depositor, and Deutsche Bank National Trust Company, Trustee, Mortgage Pass-Through Certificates Series 2006–FM1 (Apr.
be able to bring lawsuits may choose different causes of action for very similar sets of facts depending on standing and a host of other factors. For example, on the same facts, an investor may try to pursue a civil suit alleging violations of representations and warranties relating to underwriting standards in a PSA instead of pursuing a securities fraud case where the burden of proof would be higher. Put another way, plaintiffs will pursue as many or as few causes of action as they believe serves their purpose, and one case does not necessarily preclude another.

1. Fraud Claims

a. Common Law Fraud

Property law is principally a state issue, and the foreclosure irregularities first surfaced in depositions filed in state courts. Accordingly, one option for plaintiffs may be to pursue a common law fraud claim. The bar for proving common law fraud, however, is fairly high. In order to prove common law fraud, the plaintiff must establish five elements: (1) That the respondent made a material statement; (2) that the statement was false; (3) that the respondent made the statement with the intent to deceive the plaintiff; (4) that the plaintiff relied on the statement; and (5) that the plaintiff suffered injury as a result of that reliance.110

Traditionally, in order to prove common law fraud under state laws, each element detailed above has to be satisfied to the highest degree of rigor. Each state’s jurisprudence has somewhat different relevant interpretive provisions, and common law fraud is generally perceived as a fairly difficult claim to make.111 In particular, the requirement of intent has been very difficult to show, since it requires more than simple negligence.112

b. Securities Fraud

i. Foreclosure Irregularities

In the wake of the revelations about foreclosure irregularities, a number of government agencies have gotten involved. The Securities and Exchange Commission (SEC) is reviewing the mortgage securitization process and market participants for possible securities law violations. It has also provided specific disclosure guidance.

1 See Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1069 (Fed. Cir. 1998) (citing W. Prosser, Law of Torts, §§ 100–05 (3d ed. 1964) and 37 C.J.S. Fraud § 3 (1943)).

to public companies for their quarterly reports.\textsuperscript{113} Since many of the mortgages potentially affected by faulty documentation practices were put into securitization pools, there is an increased potential for lawsuits by investors, including securities law claims.

In order for MBS investors to state a securities fraud claim against investment or commercial bank sponsors under the Securities Exchange Act of 1934’s Rule 10b–5,\textsuperscript{114} the most common private litigant cause of action, the investors must prove: (1) A material misrepresentation or omission; (2) wrongful intent; (3) connection to the purchase or sale of the security; (4) reliance by the purchaser on the information; (5) economic loss to the plaintiff; and (6) causation.\textsuperscript{115}

To be sure, private investor lawsuits have been ongoing since the end of 2006 without much success.\textsuperscript{116} Some argue that securities fraud was not at the heart of the financial crisis, and securities fraud claims are bound to fail because of the typically extensive disclosure on risks associated with these transactions.\textsuperscript{117} A number of judges seem to agree: some important cases “suggest judicial skepticism to claims arising from the mortgage and financial crises.”\textsuperscript{118} The main hurdle in these securities claims—beyond establishing that the misrepresentations were so material that without them the investment would not have been made—is to establish “loss causation,” i.e., that the misrepresentations caused the investor’s losses directly. Any losses caused by unforeseeable external factors such as “changed economic circumstances” or “new indu-

\textsuperscript{113} SEC conversations with Panel staff (Nov. 15, 2010). In addition, the SEC’s Division of Corporation Finance has provided disclosure guidance for the upcoming quarterly reports by affected companies. U.S. Securities and Exchange Commission, Sample Letter Sent to Public Companies on Accounting and Disclosure Issues Related to Potential Risks and Costs Associated With Mortgage and Foreclosure-Related Activities or Exposures (Oct. 2010) (online at www.sec.gov/divisions/corpfin/guidance/cfiforeclosure1010.htm) (hereinafter “Sample SEC Letter on Disclosure Guidelines’’). If the disclosure proves misleading, it could provide the basis for another cause of action.

\textsuperscript{114} 17 CFR 240.10b–5. It is important to note that other causes of action are available under the Securities Act of 1933 for registered offerings: Under Section 11, a claim may be made for a false or misleading statement in the registration statement, and the issuer of the security, the special purpose vehicle, underwriters, and auditors will all be subject to potential Section 11 liability (with the latter two groups having due diligence defenses). With respect to other communications made during the registered offering process, misleading statements can give rise to Section 12(a)(2) liability. See 15 U.S.C. §§ 77k, 77m.


\textsuperscript{118} A recent update on subprime and credit crisis-related litigation summarizes a number of cases and analyzes why many of them failed (for example, lack of standing and lack of wrongful intent). Gibson, Dunn & Crutcher LLP, 2010 Mid-Year Securities Litigation Update (Aug. 9, 2010) (online at gibsondunn.com/Publications/Pages/Securitieslitigation2010Mid-YearUpdate.aspx#toc268774214). The update also references a report by NERA Economic Consulting on a decrease in securities law filings since 2009. See National Economic Research Associates, Inc. Trends 2010 Mid-Year Study: Filings Decline as the Wave of Credit Crisis Cases Subsidies, Median Settlement at Record High (July 27, 2010) (online at www.nera.com/67_6813.htm).
try-specific conditions” will not be recoverable. Defendants in subprime litigation cases are likely to argue that the crash of the housing market, for example, was just such an unexpected new industry-specific condition. Losses occurring as a result of the market’s crash would be non-recoverable even if there was a material misrepresentation. It remains to be seen how securities fraud cases would play out in the context of the current documentation irregularities.

Of course, the SEC has other tools at its disposal should it choose to pursue action against any of the financial institutions involved in potential documentation irregularities. For example, if a formal SEC investigation finds evidence of wrongdoing, the SEC may order an administrative hearing to determine responsibility for the violation and impose sanctions. Administrative proceedings can only be brought against a person or firm registered with the SEC, or with respect to a security registered with the SEC. Many times these actions end with a settlement, but the SEC often seeks to publish the settlement terms.

ii. Due Diligence Firms

There is also the possibility of distinct claims against the institutions that acted as securitization sponsors for their use of third-party due diligence firms. Specifically, before purchasing a pool of loans to securitize, the securitization sponsors, usually banks or investment firms, hired a third-party due diligence firm to check if the loans in the pool adhered to the seller’s underwriting guidelines and complied with federal, state, and local regulatory laws. The sponsor would select a sample of the total loan pool, typically around 10 percent, for the due diligence firm to review. The due diligence firm reviewed the sample on a loan-by-loan basis and categorized each as not meeting the guidelines, not meeting the guidelines, and meeting the guidelines. The aggregated results do not form a meaningful basis for comparison between clients and the data cannot be used to draw conclusions. Finally, Mr. Johnson had stated that Clayton examined a number of prospectuses to determine if the information from Clayton’s due diligence reports had been included. Mr. Bossidy clarified that Clayton was not actively reviewing prospectuses but had begun only in 2007 in response to specific questions from regulators. Letter from Paul T. Bossidy, president and chief executive officer, Clayton Holdings, LLC, to Phil Angelides, chairman, Financial Crisis Inquiry Commission, Re: September 23, 2010 Sacramento Hearing (Sept. 30, 2010) (online at ftc.gov/news/pdfs/2010-1014-Clayton-Letter-to-FCIC.pdf) (hereinafter “Letter from Paul Bossidy to Phil Angelides”).

120 For a more complete discussion of this theory, see Harvard Law School Discussion Paper on Subprime Litigation, supra note 116, at 42–44.
122 Id. at 2. A sample size of only around 10 percent of the total loans in the pool was low by historical standards. In the past, sample sizes were between 50 percent and 100 percent. Financial Crisis Inquiry Commission, Testimony of Keith Johnson, former president, Clayton Holdings, Transcript: Impact of the Financial Crisis—Sacramento, at 183 (Sept. 23, 2010) (online at ftc.gov/hearings/pdfs/2010-0923-transcript.pdf) (hereinafter “Testimony of Keith Johnson before the FCIC”). In his letter to the FCIC after Mr. Johnson’s testimony, the current president of Clayton Holdings, Paul T. Bossidy, contested some of Mr. Johnson’s testimony. Calling the testimony “inaccurate,” he corrected Mr. Johnson on three points. First, Mr. Johnson testified during the hearing about meetings he had had with the rating agencies in which he showed Clayton’s Exception Tracking reports. Mr. Bossidy stated that Clayton had never disclosed client data during these meetings and that Clayton had never expressed concerns about the securitization process or the ratings being issued. Second, Mr. Bossidy cautioned that the exception tracking data provided to the FCIC was from “beta” reports. These reports contain valid client-level data, but are not standardized across clients. Different clients have different standards and guidelines, leading to different exception rates. Thus, the aggregated results do not form a meaningful basis for comparison between clients and the data cannot be used to draw conclusions. Finally, Mr. Johnson had stated that Clayton examined a number of prospectuses to determine if the information from Clayton’s due diligence reports had been included. Mr. Bossidy clarified that Clayton was not actively reviewing prospectuses but had begun only in 2007 in response to specific questions from regulators. Letter from Paul T. Bossidy, president and chief executive officer, Clayton Holdings, LLC, to Phil Angelides, chairman, Financial Crisis Inquiry Commission, Re: September 23, 2010 Sacramento Hearing (Sept. 30, 2010) (online at ftc.gov/news/pdfs/2010-1014-Clayton-Letter-to-FCIC.pdf) (hereinafter “Letter from Paul Bossidy to Phil Angelides”).
lines but having compensating factors, or meeting the guidelines. Those specific loans that did not meet the guidelines, called exceptions, were returned to the sellers unless the securitization sponsors waived their objections. One due diligence firm found that, from the first quarter 2006 to second quarter 2007, only 54 percent of the loans they sampled met all underwriting guidelines.

Rejected loans from the sample were returned to the seller. The sample, though, was only approximately 10 percent of the loans in the pool, and the low rate of compliance indicated that there were likely other non-compliant loans in the pool. The securitization sponsors did not then require due diligence on a larger sample to identify non-compliant loans. Instead, some assert that the sponsors used the rate of non-compliant loans to negotiate a lower price for the pool of loans. These loan pools were subsequently sold to investors but, reports claim, the results of the due diligence were not disclosed in the prospectuses except for standard language that there might be underwriting exceptions.

This behavior raises at least two potential securities fraud claims. The first is a Rule 10b–5 violation. Rule 10b–5 prohibits “omitting to state any material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.” If the sponsors used the due diligence reports to negotiate a lower price, the information may have been material. In addition, the reports were not publicly available. On the other hand, the courts may find the standard disclosures, that there might be underwriting exceptions, to be sufficient disclosure. As yet, the 10b–5 claim is untested in the courts, and the facts are still unproven.

Another potential claim is based on Section 17 of the Securities Act of 1933, which makes it unlawful in the “offer or sale of any securities . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.” This claim also depends on unproved facts, but if the

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123 This description is just a summary. For a more complete description of one due diligence firm’s process, see Financial Crisis Inquiry Commission, Testimony of Vicki Beal, senior vice president, Clayton Holdings, Transcript: Impact of the Financial Crisis—Sacramento, at 156–158 (Sept. 23, 2010) (online at fcic.gov/hearings/pdfs/2010-0923-transcript.pdf) (hereinafter “Testimony of Vicki Beal before the FCIC”).

124 Financial Crisis Inquiry Commission, All Clayton Trending Reports: 1st Quarter 2006—2nd Quarter 2007, Impact of the Financial Crisis—Sacramento (Sept. 23, 2010) (online at www.fcic.gov/hearings/pdfs/2010-0923-Clayton-All-Trending-Report.pdf). Eighteen percent of sampled loans did not meet guidelines but had compensating factors. Eleven percent of loans were non-compliant loans, but objections were waived. Seventeen percent of the loans in the sample were rejected. In his letter to the FCIC noted above, Mr. Bossidy cautioned the FCIC from relying on aggregated exception information. The exception tracking data provided to the FCIC was from “beta” reports which contain valid client-level data, but are not standardized across clients. Different clients use different standards and guidelines, leading to different exception rates. Letter from Paul Bossidy to Phil Angelides, supra note 122.

125 Testimony of Keith Johnson before the FCIC, supra note 122, at 177–78; Testimony of Vicki Beal before the FCIC, supra note 123, at 177.

126 Testimony of Keith Johnson before the FCIC, supra note 122, at 183, 210–211.

127 Written Testimony of Vicki Beal before the FCIC, supra note 121, at 3.

128 17 CFR 240.10b5.

129 17 CFR 240.10b5.

130 Written Testimony of Vicki Beal before the FCIC, supra note 121, at 3 (“The work product produced by Clayton is comprised of reports that include loan-level data reports and loan exception reports. Such reports are ‘works for hire,’ the property of our clients and provided exclusively to our clients.”).

securitization sponsors used the due diligence reports to negotiate a lower price for the loan pools, the information is arguably material. As such, the sponsors may have violated Section 17 when they omitted the results of the due diligence reports from the prospectuses, though the proposition has not yet been ruled on by a court. Section 17, however, can only be enforced by the SEC, and not by private litigants.

There are suggestions in the press that authorities are examining the issue, with several news reports referencing discussions with investigators or prosecutors.132

2. Existing and Pending Claims under Various Fraud Theories

Currently, these issues are being explored at the state level and, as discussed above, the private investor level. The recent disclosures about robo-signing may provide additional causes of action and additional arguments for private lawsuits asking for put-backs of deficient loans. In response to a question at the Panel’s most recent hearing on housing issues, however, one of the witnesses indicated that he was not aware of any successful put-backs for foreclosure procedure problems alone.133 According to some consumer lawyers who are significantly involved in these proceedings, while it is very unlikely that a national class action lawsuit based on wrongful foreclosure claims could be successfully filed, it may be possible on a state-by-state basis.134 The outcome in these cases is uncertain, and consumer lawyers said that at this point it would be difficult to quantify potential losses arising out of these actions or any similar challenges in individual foreclosure procedures.135

Various states are proceeding under a variety of theories. As noted above, on October 13, 2010, all 50 state attorneys general, as well as state bank and mortgage regulators, announced that they would pursue a “bi-partisan multistate group” to investigate foreclosure irregularities.136 They are working together to investigate allegations of questionable and potentially fraudulent foreclosure documentation practices, and may design rules to improve foreclosure practices. They also may begin individual actions against some of the implicated institutions. On October 6, 2010, Ohio Attorney General Richard Cordray filed a suit against GMAC Mortgage and its parent Ally Financial, alleging that the companies

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134 Consumer lawyers conversations with Panel staff (Nov. 9, 2010).

135 50 States Sign Mortgage Foreclosure Joint Statement, supra note 26.
committed common law fraud and violated the Ohio Consumer Sales Practices Act.\textsuperscript{137} In response, GMAC referred to the irregularities as “procedural mistakes” and maintained that it would defend itself “vigorously.”\textsuperscript{138} The Ohio state attorney general alleges that “GMAC and its employees committed fraud on Ohio consumers and Ohio courts by signing and filing hundreds of false affidavits in foreclosure cases.” He argues that the defendants’ actions were both against the Ohio Consumer Sales Practices Act and constituted common law fraud.\textsuperscript{139} The attorney general has asked the court to halt affected foreclosures until defendants remedy their faulty practices and to require them to submit written procedures to the attorney general and the court to ensure that no employee signs documentation without personal knowledge.

Although Ohio is the first state to take action, it would not be surprising if others follow.\textsuperscript{140} Depositions have been taken in various foreclosure cases around the country that point to questionable practices by employees at a number of banks.\textsuperscript{141} Most of the large financial institutions that service mortgages maintain that documentation issues can be fixed relatively easily by re-submitting affidavits where appropriate and that based on their internal reviews there is no indication that the mortgage market is severely flawed. Many of the banks that temporarily suspended foreclosures have now resumed them. However, in their most recent earnings statements, many of these institutions have indicated that they set aside additional funds for repurchase reserves and potential litigation costs resulting from the foreclosure documentation irregularities.

In addition to these potential lawsuits, the Administration’s Financial Fraud Enforcement Task Force (FFETF) is in the early stages of an investigation into whether banks and other companies that submitted flawed paperwork in state foreclosure proceedings may also have violated federal laws. Treasury’s representative informed the Panel that through Treasury’s Financial Crimes Enforcement Network (FinCEN) they are actively participating in the work of the FFETF led by the Department of Justice.\textsuperscript{142}

\textsuperscript{137} Complaint, State of Ohio ex rel. Richard Cordray v. GMAC Mortgage, CI0201006984 (Lucas Cnty Ohio Ct. Common Pleas Oct. 6, 2010) (online at www.ohioattorneygeneral.gov/GMACLawsuit). The complaint also named Jeffrey Stephan as a defendant. It was Jeffrey Stephan’s testimony in a Maine foreclosure case that he signed thousands of affidavits without verifying their content that ignited the foreclosure documentation scandal.


\textsuperscript{139} The Ohio attorney general argues that the statements in the foreclosure affidavits were material and false, and the employees making them were aware that they were false and were making them anyway to induce Ohio courts and opposing parties to rely upon them, which, in turn, justifiably did so. He further argues that Ally and GMAC financially benefitted from these fraudulent practices by completing foreclosures that should not have been allowed to proceed, and the “system of justice in Ohio and Ohio borrowers have suffered and are suffering irreparable injury.” The Ohio attorney general also argues that Ally and GMAC “engaged in a pattern and practice of unfair, deceptive and unconscionable acts” in violation of the Ohio Consumer Sales Practices Act when their employees signed false affidavits and when they attempted to assign mortgage notes on behalf of MERS. Complaint, State of Ohio ex rel. Richard Cordray v. GMAC Mortgage, CI0201006984 (Lucas Cnty Ohio Ct. Common Pleas Oct. 6, 2010) (online at www.ohioattorneygeneral.gov/GMACLawsuit).

\textsuperscript{140} See Section E.3.

\textsuperscript{141} See, e.g., Deposition of Xee Moua, Wells Fargo Bank v. John P. Stipek, No. 50 2009 CA 012434XXXXMB AW (Fla. 15th Cir. Ct. Mar. 9, 2010).

\textsuperscript{142} Congressional Oversight Panel, Written Testimony of Phyllis Caldwell, chief of the Homeownership Preservation Office, U.S. Department of the Treasury, COP Hearing on TARP Foreclosure Mitigation Programs, at 13 (Oct. 27, 2010) (online at cop.senate.gov/documents/testimony-102710-caldwell.pdf) (hereinafter “Written Testimony of Phyllis Caldwell”). In addition to
Treasury is coordinating efforts with other federal agencies and regulators, including the Department of Housing and Urban Development (HUD), the Federal Housing Administration (FHA), the Federal Housing Finance Agency (FHFA), the Federal Reserve System, the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), the FDIC, the Federal Trade Commission (FTC), and the SEC.

1. To date, little has been disclosed about the investigation.

3. Other Potential Claims

Beyond the various fraud claims, there are also several other potential claims. For example, those who signed false affidavits may be guilty of perjury. Perjury is the crime of intentionally stating any fact the witness knows to be false while under oath, either in oral testimony or in a written declaration. Though the exact definition varies from state to state, perjury is universally prohibited. Affidavits such as the ones involved in the foreclosure irregularities are statements made under oath and thus clearly fall within the scope of the perjury statutes. Moreover, there are reports of robo-signers admitting in depositions that they knew they were lying when they signed the affidavits. As a result, it is possible that these individuals at least are guilty of perjury. Even without such an explicit admission, it is possible that a court could find that a robo-signer was intentionally and knowingly lying by signing hundreds of affidavits a day that attested to personal knowledge of loan documents. It is important to note, however, that perjury prosecutions are rare. For example, of the 91,835 federal cases commenced in fiscal year 2008, at most, only 342 charged perjury as the most serious offense. It is thus possible that robo-signers, though potentially guilty, will not be charged.

By contrast, the state attorneys general are already investigating whether foreclosure irregularities such as the use of robo-signers violated state unfair or deceptive acts or practices (UDAP) laws. Each state has some form of UDAP law, and most generally, they prohibit practices in consumer transactions that are deemed to be

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144 For example, the federal perjury statute states “Whoever—(1) having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered, that he will testify, declare, depose, or certify truly, or that any written testimony, declaration, deposition, or certificate by him subscribed, is true, willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true; or (2) in any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code, willfully subscribes as true any material matter which he does not believe to be true; is guilty of perjury and shall, except as otherwise expressly provided by law, be fined under this title or imprisoned not more than five years, or both.” 18 U.S.C. § 1621.


146 A Florida Law Firm, The Ticktin Law Group, P.A. has taken hundreds of depositions in which employees or contractors of various banks admitted to not knowing what they were signing or lying regarding their personal knowledge of information in affidavits. See, e.g., Deposition of Ismeta Dumanjic, La Salle Bank NA as Trustee for Washington Mutual Asset-Backed Certificates WMABS Series 2007–HE2 Trust v. Jeanette Attelus, et al., No. CACE 08060378 (Fla. 17th Cir. Ct. Dec. 8, 2009).


unfair or deceptive. 149 Individual state laws, however, can be as broad as generally prohibiting deceptive or unfair conduct or as narrow as prohibiting only a discrete list of practices or exempting all acts by banks. 150 As a result, whether there has been a UDAP violation will depend heavily on the particularities of each state’s law. The state attorneys general, though, are already examining the matter. In announcing their bipartisan multistate group, the attorneys general explicitly stated that they “believe such a process [robo-signing] may constitute a deceptive act and/or an unfair practice.” 151

4. Other State Legal Steps

In addition to the Ohio lawsuit described above and the ongoing joint investigation, some other state officials have taken concrete steps to address the foreclosure irregularities, including but not limited to: 152

• In New York, the court system now requires that those initiating residential foreclosure actions must file a new affirmation to certify that an appropriate employee has personally reviewed their documents and papers filed in the case and confirmed both the factual accuracy of these court filings and the accuracy of the notarizations contained therein. 153

• In California, a non-judicial foreclosure state, the attorney general sent a letter to JPMorgan Chase demanding that the firm stop all foreclosures unless it could demonstrate that all foreclosures had been conducted in accordance with California law. 154

The attorney general also called on all other lenders to halt foreclosures unless they can demonstrate compliance with California law. 155

• In Arizona, which is also a non-judicial foreclosure state, the attorney general sent letters on October 7, 2010 to several servicers implicated in the robo-signing scandals to demand a description of their practices and any remedial actions taken to address potential paperwork irregularities. The attorney general wrote that if any employees or agents used any of the questionable practices in connection with conducting a trustee’s sale or a foreclosure in Arizona, such use would likely constitute a violation of the Arizona Con-

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151 50 States Sign Mortgage Foreclosure Joint Statement, supra note 26.
152 This list is not a comprehensive list of state actions. States are becoming involved at a rapid pace, in a variety of ways, and from a variety of levels.
sumer Fraud Act, and the attorney general would have to take appropriate action.156

- In Ohio, in addition to his lawsuit against GMAC, the attorney general filed an *amicus curiae* brief in an individual foreclosure case asking the court to consider evidence that GMAC committed fraud that tainted the entire judicial process and to consider sanctioning GMAC.157 The attorney general also sent a letter to 133 Ohio judges asking them for information on any cases involving the robo-signer Xee Moua.158 In addition, he asked Wells Fargo Bank to vacate any foreclosure judgments in Ohio based on documents that were signed by robo-signers and to stop the sales of repossessed properties.159

- In The District of Columbia, Attorney General Peter Nickles announced on October 27, 2010 that foreclosures cannot proceed in the District of Columbia unless a mortgage deed and all assignments of the deed are recorded in public land records, and that foreclosures relying on MERS would not satisfy the requirement.160 MERS responded the next day by issuing a statement that their procedures conform to the laws of the District of Columbia and encouraged their members to contact them if they experience problems with their foreclosures.161

- In Connecticut, the attorney general started investigating GMAC/Ally and demanded that the company halt all foreclosures. He also asked the company to provide specific information relating to its foreclosure practices.162 In addition, the attorney general asked the state Judicial Department on October 1, 2010 to freeze all home foreclosures for 60 days to allow time to institute measures to assure the integrity of document filings.163 The Judicial Department refused this request.164

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159 Letter from Richard Cordray, attorney general, State of Ohio, to David Moskowitz, deputy general counsel, Wells Fargo (Oct. 29, 2010).
5. Other Possible Implications: Potential “Front-End” Fraud and Documentation Irregularities

Until the full scope of the problem is determined, it will be difficult to assess whether banks, servicers, or borrowers knew of the irregularities in the market. However, there are several signs that the problem was at least partially foreseeable. For example, numerous systems had been developed to circumvent the slow, paper-based property system in the United States. MERS, discussed in more detail above, represented an attempt to add speed and simplification to the property registration process, which in turn would allow property to be transferred more quickly and easily. MERS arose in reaction to a clash: during the boom, originations and securitizations moved extremely quickly. But the property law system that governed the underlying collateral moves slowly, and is heavily dependent on a variety of steps memorialized on paper and thus inefficient at processing enormous lending volume. While systems like MERS appeared to allow the housing market to accelerate, the legal standards underpinning the market did not change substantially. In some respects, the irregularities and the mounting legal problems in the mortgage system seem to be the consequence of the banks asking the property law system to do something that it may be largely unequipped to do: process millions of foreclosures within a relatively short period of time. The Panel emphasizes that mortgage lenders and securitization servicers should not undertake to foreclose on any homeowner unless they are able to do so in full compliance with applicable laws and their contractual agreements with the homeowner. If legal uncertainty remains, foreclosure should cease with respect to that homeowner until all matters are objectively resolved and vetted through competent counsel in each applicable jurisdiction. Satisfaction of applicable legal standards and legal certainty is in the best interests of homeowners as well as creditors and will enable all concerned parties to exercise properly their legal and contractual rights and remedies.

This combination of factors—a demand for speed, the use of systems designed to streamline a legal regime that was viewed as out-of-date, and a slow, localized legal system—may have substantially increased the likelihood that documentation would be insufficient. As discussed above, some authorities are taking direct aim at MERS and the validity of its processes. Coupled with business pressure exerted on law firms and contractors to process rapidly foreclosure documents, the system had clear risks of encouraging corner-cutting and creating substantial legal difficulties. Furthermore, even if these problems were not foreseeable from the

165 See, e.g., Federal National Mortgage Assoc. v. Nicole Bradbury, supra note 12 (requiring that the plaintiff provide, among other things, the book and page number of the mortgage, as well as the street address and stating that failure to provide a street address is sufficient to preclude summary judgment in a foreclosure proceeding).

166 See Section C, supra, discussing strains on servicers.


vantage point of the housing boom, the downturn in the housing market and the foreclosure crisis made them much more likely. In 2008 and 2009, a vast amount of attention was given to the difficulty of determining liability in the securitization market because of problems with documentation and transparency.\textsuperscript{169} At this time, servicers could have had notice of the types of documentation problems that could affect the transfer of mortgage ownership. In some cases, even when servicers were explicitly made aware of the shoddy documentation, they did little to correct the problem. One judge determined that “\textquote{r}ather than being an isolated or inadvertent instance of misconduct . . . GMAC has persisted in its unlawful document signing practices” even after it was ordered to correct its practices.\textsuperscript{170}

Some observers argue that current irregularities were not only foreseeable, but that they mask a range of potential irregularities at the stage in which the mortgages were originated and pooled. According to that view, current practices simply added to and magnified problems with the prior practices. The legal consequences of foreclosure irregularities will be magnified if the problems also plagued originations: after all, foreclosures are still a relatively limited portion of the market. If all securitizations or performing whole loans were to be affected, the consequences could be significantly greater. At this point, answers as to what exactly is the source of the problems at the front end and how severe the consequences may be going forward depend to a large degree on who is evaluating the problem. The Panel describes below the perspectives of various stakeholders in the residential mortgage market.

\textbf{a. Academics and Advocates for Homeowners}

Many lawyers and stakeholders who have worked with borrowers and servicers on a regular basis over the past few years, primarily in bankruptcy and foreclosure cases, maintain that documentation problems, including potentially fraudulent practices, have been pervasive and apparent.\textsuperscript{171} These actors, including academics who study the topic, argue that bankruptcy and foreclosure procedures have been revealing major deficiencies in mortgage servicing and

\textsuperscript{169} See, e.g., Hernando de Soto, \textit{Toxic Assets Were Hidden Assets}, Wall Street Journal (Mar. 25, 2009) (online at online.wsj.com/article/SB123793811398132049.html) (“The real villain is the lack of trust in the paper on which [subprime mortgages]—and all other assets—are printed. If we don’t restore trust in paper, the next default—on credit cards or student loans—will trigger another collapse in paper and bring the world economy to its knees.”).

\textsuperscript{170} Federal National Mortgage Assoc. v. Nicole Bradbury, \textit{supra} note 12 (“The Court is particularly troubled by the fact that Stephan’s deposition in this case is not the first time that GMAC’s high-volume and careless approach to affidavit signing has been exposed. . . . The experience of this case reveals that, despite the Florida Court’s order, GMAC’s flagrant disregard apparently persists. It is well past time for such practices to end.”). \textit{See also Section C., supra.}

\textsuperscript{171} For example, in her testimony submitted to the Congressional Oversight Panel, Julia Gordon of the Center for Responsible Lending writes: “The recent media revelations about ‘robo-signing’ highlight just one of the many ways in which servicers or their contractors elevate profits over customer service or duties to their clients, the investors. Other abuses include misaplying payments, force-placing insurance improperly, disregarding requirements to evaluate homeowners for nonforeclosure options, and fabricating documents related to the mortgage’s ownership or account status.” \textit{See Congressional Oversight Panel, Written Testimony of Julia Gordon, senior policy counsel, Center for Responsible Lending, COP Hearing on TARP Foreclosure Mitigation Programs,} at 3 (Oct. 27, 2010) (online at cop.senate.gov/documents/testimony-102710-gordon.pdf) (hereinafter “Written Testimony of Julia Gordon”).
documentation for quite some time. Professor Katherine M. Porter, a professor of law who testified at the Panel’s most recent hearing, wrote: “The robo-signing scandal should not have been a surprise to anyone; these problems were being raised in litigation for years now. Similarly, I released a study in 2007—three years ago—that showed that mortgage companies who filed claims to be paid in bankruptcy cases of homeowners did not attach a copy of the note to 40% of their claims.” According to this view, the servicing process was severely flawed, and “servicers falsify court documents not just to save time and money, but because they simply have not kept the accurate records of ownership, payments, and escrow accounts that would enable them to proceed legally.” In 2008–2009 over 1,700 lost note affidavits were filed in Broward County, Florida alone. These affidavits claim that the original note has been lost or destroyed and cannot be produced in court. It is important to recognize, however, that a lost note affidavit may not actually mean that the note has been lost. In her written testimony to the Panel, Professor Katherine Porter points out that her study of lost notes in bankruptcies “does not prove . . . whether the mortgage companies have a copy of the note and refused to produce it to stymie the consumers’ rights or to cut costs, whether the mortgage companies or their predecessors in a securitization lost the note, or whether someone other than the mortgage company is the holder/bearer of the note.”

If the lawyers’ and advocates’ assertions of widespread irregularities are correct, it could mean that potentially millions of shoddily documented mortgages have been pooled improperly into securitization trusts. Lawyers are using a lack of standing by the servicers due to ineffective conveyance of ownership of the mortgage as a defense in foreclosure cases. Some of these lawyers argue that the disconnect between what was happening on the “street level,” i.e., with the origination and documentation of mortgages, and the transfer requirements in the PSAs, is so huge that no credence can be given to the banks’ argument that the issues are merely technical. However, commentators who believe that the problem is widespread also believe that investors in these securitization pools, rather than homeowners, may be the best placed to pursue the cases on a larger scale successfully.

b. Servicers and Banks

Since the foreclosure irregularities have surfaced, the banks involved have maintained that the problems are largely procedural and technical in nature. Banks have temporarily suspended foreclosures in judicial foreclosure states in particular and looked into

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173 Written Testimony of Julia Gordon, supra note 171, at 11.

174 Legalprise Inc., Report on Lost Note Affidavits in Broward County, Florida (Oct. 2010). Legalprise is a Florida legal research firm that uses and analyzes public foreclosure court records.

175 Written Testimony of Katherine Porter, supra note 14, at 9.

176 Consumer lawyers conversations with Panel staff (Oct. 28, 2010).

177 Consumer lawyers conversations with Panel staff (Nov. 9, 2010).
their practices, but they state that they do not view these problems as fundamental either in the foreclosure area or in the origination and pooling of mortgages. The CEO of Bank of America, Brian Moynihan, noted in the company’s most recent earnings call that Bank of America has resumed foreclosures, but “it’s going to take us three or five weeks to get through and actually get all the judicial states taken care of. The teams reviewing data have not found information which was inaccurate, would affect the frame factors of the foreclosure; i.e., the customer’s delinquency, etcetera.”178 He focused on the faulty affidavits and argued that “[they] fixed the affidavit signing problem or will be fixed in very short order.”179 Many of the other large banks have issued statements in the same vein.180 Most of these banks have either not commented on the issues around the transfer of ownership of the mortgage or maintain that alleged ownership transfer problems are without merit or exaggerated.181

c. Investors

As discussed above, securitization investors have been involved in lawsuits regarding underwriting representations and warranties for some time. Investors in MBS or collateralized debt obligation (CDO) transactions have a variety of options to pursue a claim. Claims alleging violations of representations and warranties have typically focused on violations of underwriting standards regarding the underlying loans pooled into the securities. Another option may be to pursue similar claims relating to violations of representations and warranties with respect to the transfer of mortgage ownership. In the wake of the current documentation controversies, it appears that private investors may become more emboldened to pursue put-back requests and potentially file lawsuits. For example, and as discussed above, a group of investors—including FRBNY in its capacity as owner of RMBS it obtained from American International Group, Inc. (AIG)—sent a letter to Bank of America as an initial step to be able to demand access to certain loan files.182 Direct con-

178 Bank of America Q3 2010 Earnings Call Transcript, supra note 97, at 6.
179 Bank of America Q3 2010 Earnings Call Transcript, supra note 97, at 6.
180 JPMorgan Chase & Co., Financial Results 3Q10, at 15 (Oct. 13, 2010) (online at files.shareholder.com/downloads/ONE/1051047839x0x0409164/e271d82-e74-429e-8ff1-7d67096646213Q10_Earnings_Presentation.pdf) (hereinafter “JPMorgan Q3 2010 Financial Results”) (“Based on our processes and reviews to date, we believe underlying foreclosure decisions were justified by the facts and circumstances.”); Wells Fargo Update on Affidavits and Mortgage Securitizations, supra note 23 (“The issues the company has identified do not relate in any way to the quality of the customer and loan data; nor does the company believe that any of these instances led to foreclosures which should not otherwise occurred.”).

181 For example, the American Securitization Forum issued a statement questioning the legitimacy of concerns raised about securitization practices: “In the last few days, concerns have been raised as to whether the standard industry methods of transferring ownership of residential mortgage loans to securitization trusts are sufficient and appropriate. These concerns are without merit and our membership is confident that these methods of transfer are sound and based on a well-established body of law governing a multi-trillion dollar secondary mortgage market.” See American Securitization Forum, ASF Says Mortgage Securitization Legal Structures & Loan Transfers Are Sound (Oct. 15, 2010) (online at www.americansecuritization.com/story.aspx?id=4457) (hereinafter “ASF Statement on Mortgage Securitization Legal Structures and Loan Transfers”). ASF will issue a white paper in the coming weeks to elaborate further on this statement.

182 See Letter from Gibbs & Bruns LLP to Countrywide, supra note 95. As noted above, the letter predominantly alleges problems with loan quality and violation of prudent servicing obligations. See also Gibbs & Bruns LLP, Institutional Holders of Countrywide-Issued RMBS Issue Notice of Non-Performance Identifying Alleged Failures by Master Servicer to Perform Covenants and Agreements in More Than $47 Billion of Countrywide-Issued RMBS (Oct. 18, 2010) (online Continued
F. Assessing the Potential Impact on Bank Balance Sheets

1. Introduction

A bank’s exposure to the current turmoil in the residential real estate market stems from its role as the originator of the initial mortgage, its role as the issuer of the packaged securities, its role as the underwriter of the subsequent mortgage trusts to investors, and/or its role as the servicer of the troubled loan.188 Through

183 FRBNY staff conversations with Panel staff (Oct. 26, 2010).

184 For further discussion of these obstacles, see Section D.2. In addition, see description of PSAs in Section D.1, supra.

185 For example, the investors taking action have to consider costs associated with their litigation such as indemnifications to be given to trustees when those are directed to initiate a lawsuit on the bondholders’ behalf. Another consideration is that non-participating investors may also ultimately benefit from legal actions without contributing to the costs.

186 For example, in some PSAs, trustees are not required to investigate any report or, in many agreements, request put-backs, unless it is requested by 25 percent of investors. See Pooling and Servicing Agreement by and among J.P. Morgan Acceptance Corporation I, Depositor, et al., at 122 (Apr. 1, 2006) (online at www.scribd.com/doc/31453301/Pooling-Servicing-Agreement-JPMAC2006-NC1-PSA). Absent that threshold being met, the trustee has discretion to act. For further discussion, see Section D.2.

187 Amherst Securities Group LP, Conference Call: “Robosigners, MERS, And The Issues With Reps and Warrants” (Oct. 28, 2010). If the investors wished to act against trustees they believe are not independent, there are some legal avenues they could pursue. For example, the investors could remove the trustee using provisions that are typically in PSAs that allow for such a removal. Such provisions, however, often require 51 percent of investors to act. In addition, to the extent that the trustees are found to be fiduciaries, if the trustee takes a specific action that the investors believe not to be in their best interest, they may be able to sue the trustee. If successful, investors could be awarded a number of possible remedies, including damages or removal of the trustee. Greenfield, Stein, & Senior, Fiduciary Removal Proceedings (online at www.gss-law.com/PracticeAreas/Fiduciary-Removal-Proceedings.asp) (accessed Nov. 12, 2010); Gary B. Friedman, Relief Against a Fiduciary: SCPA § 2102 Proceedings, NYSBA Trusts and Estates Law Section Newsletter, at 1–2, 4 (Oct. 13, 2003) (online at www.gss-law.com/CM/Articles/SCPA%202102%20Proceedings%20-%20Revised.pdf) (“The failure of the fiduciary to comply with a court order directing that the information be supplied can be a basis for contempt under SCPA § 606, 607-1 and/or suspension or removal of the fiduciary under SCPA § 711.”)

188 There are also risks for holders of second lien loans, but these loans are not as directly impacted by foreclosure irregularities as first-lien mortgages, since most second liens were not securitized, and are held on the balance sheets of banks and other market participants. As discussed above, if second liens were perfected and first liens were not, they may actually take priority. See Section D.2 for further discussion of effects on second lien holders.

An analyst report from January 2010, values securitized second liens only at $32.5 billion of the $1.053 trillion of the total second liens outstanding. Amerihot Mortgage Insight, 2nd Liens—How Important, at 12 (Jan. 29, 2010).
At the end of the second quarter of 2010, the four largest U.S. commercial banks—Bank of America, Citigroup, JPMorgan Chase, and Wells Fargo—reported $433.7 billion in second lien mortgages while having total equity capital of $548.8 billion. Amherst Securities Group LP data provided to Panel staff (Sept. 2, 2010); Federal Deposit Insurance Corporation, Statistics of Depository Institutions (online at www2.fdic.gov/sdi/) (accessed Nov. 12, 2010). This figure is based on reporting by the banks, not their holding companies, and therefore may not include all second liens held by affiliates.

Market estimates stemming from foreclosure irregularities to a potential prolonged foreclosure moratorium range from $1.5 to $10.0 billion for the entire industry. However, while the situation remains fluid, the emerging consensus in the market is that the risk from mortgage put-backs is a potentially bigger source of instability for the banks. Using calculations based on current market estimates of investment analysts, the Panel calculates a consensus exposure for the industry of $52 billion. Aside from the potential for costs to far exceed these market estimates (or be materially lower), the wild card here is the impact of broader title documentation concerns across the broader mortgage market. In any case, the fallout from the foreclosure crisis and ongoing put-backs to the banks from mortgage investors are likely to continue to weigh on bank earnings, but are, according to industry analysts, unlikely to pose a grave threat to bank capital levels.

However, there are scenarios whereby wholesale title and legal documentation problems for the bulk of outstanding mortgages could create significant instability in the marketplace, leading to potentially significantly larger effects on the balance sheets of banks. Under significantly more severe scenarios that would engulf the broader mortgage market—encompassing widespread legal uncertainty regarding mortgage loan documentation as well as the prospect of extensive put-backs impacting agency and private label mortgages—bank capital levels could conceivably come under renewed stress, particularly for the most exposed institutions. It
is unclear whether severe mortgage scenarios were modeled in the Federal Reserve’s 2009 stress tests, which, in any event, did not examine potential adverse scenarios beyond 2010.194

While the situation is still uncertain, the worst-case scenarios would have to presuppose at a minimum a systemic breakdown in documentation standards, the consequences of which would likely grind the mortgage market to a halt. However, it is important to note that, so far, many of the experts who have spoken to the question (and the banks themselves) believe that securities documentation concerns are unlikely to trigger meaningful broad-based losses. These experts state that although put-backs owing to breaches of representations and warranties will continue to exert a toll on the banks, it will largely be manageable, with costs covered from ongoing reserves and earnings. Furthermore, as noted in Section D, there are a considerable number of legal considerations that will likely lead to losses being spread out over time.195

Residential U.S. mortgage debt outstanding was $10.6 trillion as of June 2010.196 Of this amount, $5.7 trillion is government-sponsored enterprise (GSE) or agency-backed paper, $1.4 trillion is private label (or non-GSE issued) securities, and $3.5 trillion is non-securitized debt held on financial institution balance sheets.197
Industry-wide, 4.6 percent of mortgages are classified as in the foreclosure process. In addition, 9.4 percent of mortgages are at least 30 days past due, approximately half of which are more than 90 days past due.

FIGURE 2: RESIDENTIAL (1–4 FAMILY) MORTGAGE DEBT OUTSTANDING, 1985–2009


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Delinquency rates include loans that are 30 days, 60 days, and 90 days or more past due. Foreclosure rates include loans in the foreclosure process at the end of each quarter. See Id.
a. Leading Market Participants

Troubled mortgages were largely originated in 2005–2007, when underwriting standards were most suspect, particularly for subprime, Alt-A and other loans to low-credit or poorly documented borrowers. Figure 4 below outlines the largest mortgage originators during this period, ranked by volume and market share.

**FIGURE 4: LARGEST U.S. MORTGAGE ORIGINATORS, 2005–2007 201**

[Dollars in billions]

<table>
<thead>
<tr>
<th>Company</th>
<th>Volume</th>
<th>Market Share (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of America</td>
<td>1,880</td>
<td>22.1</td>
</tr>
<tr>
<td>Countrywide Financial</td>
<td>1,362</td>
<td>16.0</td>
</tr>
<tr>
<td>Bank of America Mortgage &amp; Affiliates</td>
<td>518</td>
<td>6.1</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>1,324</td>
<td>15.5</td>
</tr>
<tr>
<td>Wells Fargo Home Mortgage</td>
<td>1,062</td>
<td>12.4</td>
</tr>
<tr>
<td>Wachovia Corporation</td>
<td>262</td>
<td>3.1</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>1,151</td>
<td>13.5</td>
</tr>
<tr>
<td>Chase Home Finance</td>
<td>566</td>
<td>6.6</td>
</tr>
<tr>
<td>Washington Mutual</td>
<td>584</td>
<td>6.9</td>
</tr>
<tr>
<td>Citigroup</td>
<td>506</td>
<td>5.9</td>
</tr>
<tr>
<td>Top Four Aggregate</td>
<td>4,861</td>
<td>57.0</td>
</tr>
<tr>
<td><strong>Total Mortgage Originations (2005–2007)</strong></td>
<td><strong>8,530</strong></td>
<td></td>
</tr>
</tbody>
</table>

201 Inside Mortgage Finance.

The four largest banks accounted for approximately 60 percent of all loan originations between 2005 and 2007. Totals for Bank of America, Wells Fargo, JPMorgan Chase, and Citigroup include volumes originated by companies that these firms subsequently acquired. As Figure 4 indicates, a significant portion of Bank of America’s mortgage loan portfolio is comprised of loans assumed upon its acquisition of Countrywide Financial. Similarly, JPMorgan Chase more than doubled its mortgage loan portfolio with its acquisition of Washington Mutual.

Figure 5, below, details the largest originators of both Alt-A and subprime loans between 2005 and 2007. The five leading originators of Alt-A and subprime loans represented approximately 56 percent and 34 percent, respectively, of aggregate issuance volume for these loan types. Alt-A and subprime loans represented approximately 30 percent of all mortgages originated from 2005 to 2007.

**FIGURE 5: LEADING ORIGINATORS OF SUBPRIME AND ALT-A LOANS, 2005–2007 202**

[Dollars in billions]

<table>
<thead>
<tr>
<th>Company</th>
<th>Volume</th>
<th>Market Share (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Countrywide Financial (Bank of America)</td>
<td>172</td>
<td>16.2</td>
</tr>
<tr>
<td>IndyMac</td>
<td>145</td>
<td>13.6</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>107</td>
<td>9.6</td>
</tr>
<tr>
<td>Washington Mutual</td>
<td>40</td>
<td>3.8</td>
</tr>
<tr>
<td>EMC Mortgage</td>
<td>38</td>
<td>3.5</td>
</tr>
<tr>
<td>Chase Home Financial</td>
<td>25</td>
<td>2.3</td>
</tr>
<tr>
<td>GMAC</td>
<td>99</td>
<td>9.2</td>
</tr>
<tr>
<td>GMAC–RFC</td>
<td>77</td>
<td>7.3</td>
</tr>
<tr>
<td>GMAC Residential Holding</td>
<td>21</td>
<td>1.9</td>
</tr>
</tbody>
</table>

202 Inside Mortgage Finance.

(Dollars in billions)

<table>
<thead>
<tr>
<th>Company</th>
<th>Volume</th>
<th>Market Share (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lehman Brothers 203</td>
<td>79</td>
<td>7.4</td>
</tr>
<tr>
<td>Top Five Aggregate</td>
<td>596</td>
<td>56.0</td>
</tr>
<tr>
<td>Total Alt-A Originations (2005–2007)</td>
<td></td>
<td>1,065</td>
</tr>
</tbody>
</table>

SUBPRIME ORIGINATIONS

<table>
<thead>
<tr>
<th>Company</th>
<th>Volume</th>
<th>Market Share (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ameriquest Mortgage</td>
<td>112</td>
<td>7.7</td>
</tr>
<tr>
<td>New Century</td>
<td>109</td>
<td>7.5</td>
</tr>
<tr>
<td>Countrywide Financial (Bank of America)</td>
<td>102</td>
<td>7.0</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>99</td>
<td>6.8</td>
</tr>
<tr>
<td>Washington Mutual</td>
<td>66</td>
<td>4.5</td>
</tr>
<tr>
<td>Chase Home Finance</td>
<td>53</td>
<td>3.3</td>
</tr>
<tr>
<td>Option One Mortgage</td>
<td>80</td>
<td>5.5</td>
</tr>
<tr>
<td>Top Five Aggregate</td>
<td>502</td>
<td>34.4</td>
</tr>
<tr>
<td>Total Subprime Origination (2005–2007)</td>
<td></td>
<td>1,458</td>
</tr>
</tbody>
</table>

202 Inside Mortgage Finance.
203 Includes Alt-A originations from Lehman Brothers subsidiary, Aurora Loan Services, LLC.

As shown in Figure 6, below, the five leading underwriters (pro forma for acquisitions) of non-agency MBS between 2005 and 2007 accounted for 58 percent of the total underwriting volume for the period. It is of note that the three firms with the largest underwriting volumes during this period, Lehman Brothers, Bear Stearns, and Countrywide Securities, have either failed or been acquired by another company.

FIGURE 6: LEADING UNDERWRITERS OF NON-AGENCY MORTGAGE-BACKED SECURITIES, 2005–2007 204

(Dollars in billions)

<table>
<thead>
<tr>
<th>Company</th>
<th>Volume</th>
<th>Market Share (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPMorgan Chase</td>
<td>593</td>
<td>19.5</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>143</td>
<td>4.7</td>
</tr>
<tr>
<td>Bear Steams</td>
<td>298</td>
<td>9.8</td>
</tr>
<tr>
<td>Washington Mutual</td>
<td>152</td>
<td>5.0</td>
</tr>
<tr>
<td>Bank of America</td>
<td>371</td>
<td>12.2</td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>94</td>
<td>3.1</td>
</tr>
<tr>
<td>Countrywide Securities</td>
<td>277</td>
<td>9.1</td>
</tr>
<tr>
<td>Lehman Brothers</td>
<td>322</td>
<td>10.6</td>
</tr>
<tr>
<td>RBS Greenwich Capital</td>
<td>273</td>
<td>9.0</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>203</td>
<td>6.7</td>
</tr>
<tr>
<td>Top Five Aggregate</td>
<td>1,762</td>
<td>58.0</td>
</tr>
<tr>
<td>Total Underwriting Volume (2005–2007)</td>
<td></td>
<td>3,044</td>
</tr>
</tbody>
</table>

204 Inside Mortgage Finance.

As noted above, banks either retain or securitize—market conditions permitting—the mortgage loans they originate. In terms of mortgages retained on bank balance sheets, Figure 7 below lists banks with the largest mortgage loan books, as well as the concentration of foreclosed mortgage loans, ranked by volume and as a percentage of overall residential mortgage balance sheet assets.
Bank of America is frequently mentioned by analysts as having potentially high exposure, in part because of its purchase of Countrywide Financial and Merrill Lynch, which was heavily involved in CDOs, and its assumption of successor liability. During the Panel’s October 27, 2010 hearing, Guy Cecala of Inside Mortgage Finance noted that Bank of America was one of the leading mortgage servicers.

The leading mortgage servicers are ranked below by loan volume serviced and market share, including the percentage of the overall portfolio in foreclosure. During the second quarter of 2010, the 10 largest servicers in the United States were responsible for servicing 67.2 percent of all outstanding residential mortgages.

### FIGURE 7: BANK HOLDING COMPANIES WITH 1–4 FAMILY LOANS IN FORECLOSURE PROCEEDINGS, JUNE 2010

<table>
<thead>
<tr>
<th>Company</th>
<th>Total 1–4 Family Loans</th>
<th>1–4 Family Loans in Foreclosure</th>
<th>Percent of 1–4 Family Loans in Foreclosure (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of America</td>
<td>427.1</td>
<td>18.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>370.7</td>
<td>17.6</td>
<td>4.7</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>259.9</td>
<td>19.5</td>
<td>7.5</td>
</tr>
<tr>
<td>Citigroup</td>
<td>178.4</td>
<td>6.0</td>
<td>3.3</td>
</tr>
<tr>
<td>HSBC North America</td>
<td>72.9</td>
<td>6.6</td>
<td>9.0</td>
</tr>
<tr>
<td>U.S. Bancorp</td>
<td>58.1</td>
<td>2.5</td>
<td>4.4</td>
</tr>
<tr>
<td>PNC Financial Services Group</td>
<td>54.9</td>
<td>2.7</td>
<td>5.0</td>
</tr>
<tr>
<td>SunTrust Banks</td>
<td>47.9</td>
<td>2.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Ally Financial (GMAC)</td>
<td>21.5</td>
<td>2.2</td>
<td>10.2</td>
</tr>
<tr>
<td>Fifth Third Bancorp</td>
<td>21.4</td>
<td>0.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Total for All Bank Holding Companies</td>
<td>2,152.2</td>
<td>87.7</td>
<td>4.1</td>
</tr>
</tbody>
</table>

205 SNL Financial. These data include revolving or permanent loans secured by real estate as evidenced by mortgages (FHA, FHA, VA, or conventional) or other liens (first or junior) secured by 1–4 family residential property.

206 As a point of reference, as of June 2010, 63 percent of foreclosures occurred on homes where the loan was either owned or guaranteed by government investors such as Fannie Mae and Freddie Mac, while the remaining 37 percent were on homes owned by private investors. Data on percentage of portfolio in foreclosure unavailable for Ally Financial, U.S. Bancorp, OneWest Bank, and PNC Financial Services Group. Inside Mortgage Finance.

2. Foreclosure Irregularities: Estimating the Cost to Banks

Assessing the potential financial impact of foreclosure irregularities, including a prolonged foreclosure moratorium, on bank stability is complicated by the extremely fluid nature of current developments. For example, after unilaterally halting foreclosure proceedings, both Bank of America and Ally Financial (GMAC) an-
nounced their intention to resume foreclosure proceedings in the wake of internal reviews that did not uncover systemic irregularities, according to both firms.\textsuperscript{208} Looking ahead, the chief variables are the extent and duration of potential foreclosure disruptions or an outright moratorium, which would impact servicing and foreclosure costs and housing market prices (and recovery values). Such scenarios would also likely increase litigation and legal risks, including potential fines from state attorneys general, as well as raising questions regarding the extent to which title irregularities may permeate the system.\textsuperscript{209}

During recent conference calls for third quarter 2010 earnings and subsequent investor presentations, the five largest mortgage servicers addressed questions regarding foreclosure irregularities and potential liabilities stemming from these issues.\textsuperscript{210}

- **Bank of America**\textsuperscript{211}—Bank of America initially suspended foreclosure sales on October 8, 2010 across all 50 states after reviewing its internal foreclosure procedures. On October 18, 2010, the bank began amending and re-filing 102,000 foreclosure affidavits in 23 judicial foreclosure states, a process expected to take three to five weeks to complete. While asserting that it is addressing issues surrounding affidavit signatures, the company claims that it has not been able to identify any improper foreclosure decisions.\textsuperscript{212}

\begin{ex}
\textsuperscript{208} Bank of America Q3 2010 Earnings Call Transcript, supra note 97, at 6 (“On the foreclosure area . . . we changed and started to initiate the foreclosures . . . ’’); GMAC Mortgage Statement on Independent Review and Foreclosure Sales, supra note 20 (“In addition to the nationwide measures, the review and remediation activities related to cases involving judicial affidavits in the 23 states continues and has been underway for approximately two months. As each of those files is reviewed, and remediated when needed, the foreclosure process resumes. GMAC Mortgage has found no evidence to date of any inappropriate foreclosures.”).

\textsuperscript{209} See Section F.3 for further discussion on potential bank liabilities from securitization title irregularities and mortgage repurchases or put-backs.

\textsuperscript{211} In October 2010, the SEC sent a letter to Chief Financial Officers of certain public companies to remind them of their disclosure obligations relating to the foreclosure documentation irregularities. See Sample SEC Letter on Disclosure Guidelines, supra note 113. The letter noted that affected public companies should carefully consider a variety of issues relating to foreclosure documentation irregularities, including trends, known demands, commitments and other similar elements that might “reasonably expect to have a material favorable or unfavorable impact on your results of operations, liquidity, and capital resources.” Although the letter notes a variety of areas that would require disclosure, the quality of disclosure will depend on what the companies in question are able to determine about the effect of the irregularities on their operations. Genuine uncertainty will result in less useful disclosure. Once the information is provided in a report, however, companies have a duty to update it if it becomes inaccurate or misleading.

\textsuperscript{212} It was recently reported that Bank of America found errors in 10 to 25 foreclosure cases out of the first several hundred the bank has examined. Written Testimony of Katherine Porter, supra note 14, at 10; Jessica Hall & Anand Basu, Bank of America Corp Acknowledged Some Mistakes in Foreclosure Files as it Begins to Resubmit Documents in 102,000 Cases, the Wall Street Journal Said, Reuters (Oct. 25, 2010) (online at www.reuters.com/article/ idUSTRE69004220101025). Bank of America expects increased costs related to irregularities in its foreclosure affidavit procedures during the fourth quarter of 2010 and into 2011. Costs associated with reviewing its foreclosure procedures, revising affidavit filings, and making other operational changes will likely result in lower noninterest expense, including higher servicing costs and legal expenses. Furthermore, Bank of America anticipates higher servicing costs over the long term if it must make changes to its foreclosure process. Finally, the time to complete foreclosure sales may increase temporarily, which may increase nonperforming loans and servicing advances and may impact the collectability of such advances, as well as the value of the bank’s mortgage servicing rights. Bank of America Corporation, Form 10-Q for the Quarterly
\end{ex}
• **Citigroup**—Citigroup has not announced plans to halt its foreclosure proceedings. The bank has nonetheless initiated an internal review of its foreclosure process due to increased industry-wide focus on foreclosure processes. It has not identified any issues regarding its preparation and transfer of foreclosure documents thus far. However, Citigroup noted in a recent filing that its current foreclosure processes and financial condition could be affected depending on the results of its review or if any industry-wide adverse regulatory or judicial actions are taken on foreclosures.

• **JPMorgan Chase**—Beginning in late September to mid-October 2010, JPMorgan Chase delayed foreclosure sales across 40 states, suspending approximately 127,000 loan files currently in the foreclosure process. While the company, similar to Bank of America, has identified issues relating to foreclosure affidavits, it does not believe that any foreclosure decisions were improper. On November 4, 2010, JPMorgan Chase stated that it will begin re-filing foreclosures within a few weeks. The firm also stated in a recent filing that it is developing new processes to ensure it satisfies all procedural requirements related to foreclosures.

• **Wells Fargo**—Wells Fargo expressed confidence in its foreclosure documentation practices and reiterated that the firm has no plans to suspend foreclosures. The bank added that an internal review identified instances where the final affidavit review and some aspects of the notarization process were not properly executed. Accordingly, Wells Fargo is submitting supplemental affidavits for approximately 55,000 foreclosures in 23 judicial foreclosure states.

• **Ally Financial (GMAC)**—As of November 3, 2010, GMAC Mortgage reviewed 9,523 foreclosure affidavits, with review...
pending on an additional 15,500 files. The company noted that its review to date has not identified any instances of improper foreclosures. Where appropriate, GMAC re-executed and refiled affidavits with the courts. GMAC stated that it has modified its foreclosure process, increased the size of its staff involved in foreclosures, provided more training, and enlisted a “specialized quality control team” to review each case. The company expects to complete all remaining foreclosure file reviews by the end of the year. Furthermore, GMAC recently implemented supplemental procedures for all new foreclosure cases in order to ensure that affidavits are properly prepared.

While a market-wide foreclosure moratorium appears less likely following comments from the Administration and internal reviews by the affected banks, state attorneys general have yet to weigh in on the issue. Market estimates of possible bank losses related to a foreclosure moratorium have varied considerably, from $1.5 billion to $10 billion. Industry analysts have noted that a three-month foreclosure delay could increase servicing costs and losses on foreclosed properties. In addition, banks could also face added litigation costs associated with resolving flawed foreclosure procedures. However, these estimates can of course become quickly outdated in the current environment. As noted, firms that previously suspended foreclosures are now beginning to re-file and re-execute foreclosure affidavits, and market estimates accounting for shorter foreclosure moratoriums are currently unavailable.

Although they have not been implicated in the recent news of foreclosure moratoriums, thousands of small to mid-level banks also face some risk from foreclosure suspensions if they act as servicers for larger banks. Generally, small community banks, as well as credit unions, are more likely to keep mortgage loans on their books as opposed to selling them in the secondary market. They primarily use securitization to hedge risk and increase lending power. Accordingly, foreclosure moratoriums would prevent small banks and credit unions from working through nonperforming loans on their balance sheets, limiting their capacity to originate new loans.

As of June 2010, residential mortgages

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223 A Credit Suisse research note estimated that Bank of America, JPMorgan Chase, and Wells Fargo could each face $500 million-$600 million in increased servicing costs and write-downs on foreclosed homes, assuming a three-month foreclosure delay and associated costs and write-downs approximating 1 percent per month. An FBR Capital Markets research note estimated $6 billion-$10 billion in potential losses from a three-month foreclosure moratorium across the entire banking industry. This estimate assumes that there are approximately 2 million homes currently in the foreclosure process, and that the costs of a delay on each foreclosed property is $1,000 per month. Credit Suisse, Mortgage Issues Mount, at 10 (Oct. 15, 2010) (hereinafter “Credit Suisse on Mounting Mortgage Issues”); FBR Foreclosure Mania Conference Call, supra note 3.

224 FBR Foreclosure Mania Conference Call, supra note 3.

225 Treasury conversations with Panel staff (Oct. 21, 2010).

226 Third Way staff conversations with Panel staff (Oct. 29, 2010).

made up 31 percent of small banks’ loan portfolios and 55 percent of credit union portfolios.\(^{228}\)

## 3. Securitization Issues and Mortgage Put-backs

Foreclosure documentation issues highlight other potential—and to some degree, related—mortgage market risks to the banking sector. Questions regarding document standards in the foreclosure process are tangential to broader concerns impacting bank’s representations and warranties to mortgage investors, as well as concerns regarding proper legal documentation for securitized loans.

Given the lack of transparency into documentation procedures and questions as to the capacity of disparate investor groups to centralize claims against the industry, market estimates of potential bank liabilities stemming from securitization documentation issues vary widely.

### a. Securitization Title

As discussed above, documentation standards in the foreclosure process have helped shine a light on potential questions regarding the ownership of loans sold into securitization without the proper assignment of title to the trust that sponsors the mortgage securities. There are at least three points at which the mortgage and the note must be transferred during the securitization process in order for the trust to have proper ownership of the mortgage and the note and thereby the authority to foreclose if necessary. Concerns that the proper paperwork was not placed in the securitization trust within the 90-day window stipulated by law have created uncertainty in MBS markets.

Any lack of clarity regarding the securitization trust’s clear ownership of the underlying mortgages creates an atmosphere of uncertainty in the market and a bevy of possible problems. A securitization trust is not legally capable of taking action on mortgages unless it has clear ownership of the mortgages and the notes. Therefore, possible remedies for loans that are seriously delinquent—such as foreclosure, deed-in-lieu, or short sale—would not be available to the trust.\(^{229}\) Litigation appears likely from purchasers of MBS who have possible standing against the trusts that issued the MBS. Claimants will contend that the securitization trusts created securities that were based on mortgages which they did not own. Since the nation’s largest banks often created these securitization trusts or originated the mortgages in the pool, in a worst-case scenario it is possible that these institutions would be

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\(^{229}\) A deed-in-lieu permits a borrower to transfer their interest in real property to a lender in order to settle all indebtedness associated with that property. A short sale occurs when a servicer allows a homeowner to sell the home with the understanding that the proceeds from the sale may be less than is owed on the mortgage. U.S. Department of the Treasury, Home Affordable Foreclosure Alternatives (HAFA) Program (online at makinghomeaffordable.gov/hafa.html) (accessed Nov. 12, 2010).
forced to repurchase the MBS the trusts issued, often at a significant loss.

On October 15, 2010, the American Securitization Forum (ASF) asserted that concerns regarding the legality of loan transfers for securitization were without merit. The statement asserted that the ASF’s member law firms found that the “conventional process for loan transfers embodied in standard legal documentation for mortgage securitizations is adequate and appropriate to transfer ownership of mortgage loans to the securitization trusts in accordance with applicable law.”

b. Forced Mortgage Repurchases/Put-backs

In the context of the overall $7.6 trillion mortgage securitization market, approximately $5.5 trillion in MBS were issued by the GSEs and $2.1 trillion by non-agency issuers. As discussed above, and distinct from the foreclosure irregularities and securitization documentation concerns, banks make representations and warranties regarding the mortgage loans pooled and sold into GSE and private-label securities. A breach of these representations or warranties allows the purchaser to require the seller to repurchase the specific loan.

While these representations and warranties vary based on the type of security and customer, triggers that may force put-backs include undisclosed liabilities, income or employment misrepresentation, property value falsification, and the mishandling of escrow funds. Thus far, loans originated in 2005–2008 have the highest concentration of repurchase demands. Repurchase volumes stemming from older vintages have not had a material effect on the nation’s largest banks, and due to tightened underwriting standards implemented at the end of 2008, it appears unlikely that loans originated after 2008 will have a high repurchase rate, although the enormous uncertainty in the market makes it difficult to predict repurchases with any degree of precision.

There are meaningful distinctions between the capacity of GSEs and private-label investors to put-back loans to the banks. This helps explain why the vast majority of put-back requests and successful put-backs relate to loans sold to the GSEs. This also helps estimate the size of the potential risks to the banks from non-agency put-backs. GSEs benefit from direct access to the banks’ loan files and lower hurdles for breaches of representations and warranties due to the relatively higher standard of loan underwriting. Private label investors, on the other hand, do not have access to loan files, and instead must aggregate claims to request a review of loan

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230 ASF Statement on Mortgage Securitization Legal Structures and Loan Transfers, supra note 181. Some observers question whether, even if the procedures in the PSA were legally sound, they were actually accomplished. Consumer lawyers conversations with Panel staff (Nov. 9, 2010).


233 It is unlikely that earlier vintages will pose a repurchase risk given the relatively more seasoned nature of these securities.
files.234 Moreover, and perhaps more importantly, private label securities often lack some of the representations and warranties common to agency securities. For example, Wells Fargo indicated that approximately half of its private label securities do not contain all of the representations and warranties typical of agency securities.235 Also, given that private label securities are often composed of loans to borrowers with minimal to non-existent supporting loan documentation, many do not contain warranties to protect investors from borrower fraud.236

Since the beginning of 2009, the four largest banks incurred $11.4 billion in repurchase expenses, with the group’s aggregate repurchase reserve increasing to $9.9 billion as of the third quarter 2010.237 Bank of America incurred a total of $4.5 billion in expenses relating to representations and warranties during this period—nearly 40 percent of the $11.4 billion total that the top four banks have reported.238

FIGURE 9: ESTIMATED REPRESENTATION AND WARRANTIES EXPENSE AND REPURCHASE RESERVES AT LARGEST BANKS 239

<table>
<thead>
<tr>
<th></th>
<th>Estimated Representation and Warranty Expense</th>
<th>Estimated Ending Repurchase Reserves</th>
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<tbody>
<tr>
<td></td>
<td>FY 2009</td>
<td>Q1 2010</td>
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<tr>
<td>Bank of America</td>
<td>$1,900</td>
<td>$526</td>
</tr>
<tr>
<td>Citigroup</td>
<td>526</td>
<td>5</td>
</tr>
<tr>
<td>J P Morgan</td>
<td>940</td>
<td>432</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>927</td>
<td>402</td>
</tr>
<tr>
<td>Total</td>
<td>$4,293</td>
<td>$1,365</td>
</tr>
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239 Id. at 10.

GSE Put-backs

As of June 2010, 63 percent of foreclosures occurred on homes where the loan was either owned or guaranteed by government investors such as Fannie Mae and Freddie Mac, while the remaining 37 percent of foreclosures were on homes owned by private investors.240 A large portion of these loans were originated and sold by...
The nation's largest banks. As Figure 10 illustrates, the nation's four largest banks sold a total of $3.1 trillion in loans to Fannie Mae and Freddie Mac from 2005–2008.

FIGURE 10: LOANS SOLD TO FANNIE MAE AND FREDDIE MAC, 2005–2008

GSEs have already forced banks to repurchase $12.4 billion in mortgages. Bank of America, which has the largest loan portfolio in comparison to its peers, has received a total of $18.0 billion in representation and warranty claims from the GSEs on 2004–2008 vintages. Of this total, Bank of America has resolved $11.4 billion, incurring $2.5 billion in associated losses. However, the bank believes that it has turned the corner in terms of new repurchase requests from the GSEs. Further, the passage of time is apparently on the banks' side here, as JPMorgan Chase noted that breaches of representations and warranties generally occur within 24 months of the loan being originated. JPMorgan Chase noted that delinquencies or foreclosures on loans aged more than two years generally reflect economic hardship of the borrower.

percent in June 2010. The same dichotomy is seen in the number of loans in the process of foreclosure. As of June 2010, 2.3 percent of loans owned or guaranteed by the GSEs were in the foreclosure process, whereas 8.0 percent of loans owned by private investors were classified as such. Staff calculations derived from Office of the Comptroller of the Currency and Office of Thrift Supervision, OCC and OTS Mortgage Metrics Report: Second Quarter 2010, at Tables 9, 10, 11 (Sept. 2010) (hereinafter “OCC and OTS Mortgage Metrics Report”); Foreclosure completion information provided by OCC/OTS in response to Panel request.

Credit Suisse on Mounting Mortgage Issues, supra note 223.


Bank of America Presentation at BancAnalysts Association of Boston Conference, supra note 236, at 12.

Bank of America Presentation at BancAnalysts Association of Boston Conference, supra note 236, at 12 (“We estimate we are roughly two-thirds through with GSE claims on 2004–2008 vintages.”).

JPM Presentation at BancAnalysts Association of Boston Conference, supra note 217, at 22 (“More recent additions to 90 DPD [days past due] have longer histories of payment; we believe loans going delinquent after 24 months of origination are at lower risk of repurchase.”).

JPM Presentation at BancAnalysts Association of Boston Conference, supra note 217, at 24 (“45% of losses-to-date from loans that paid for 25+ months before delinquency; Bank of America Merrill Lynch, R&W: Investor hurdles mitigate impact; GSE losses peaking (Nov. 8, 2010) (“Delinquency after 2 years of timely payment materially reduces the likelihood of repur-
Private-Label Put-backs

In comparison with the GSEs, private-label investors do not benefit from the same degree of protection through the representations and warranties common in the agency PSAs. There were, however, representations and warranties in private-label securities that, if violated, could provide an outlet for mortgage put-backs. In theory, systemic breaches in these securities could prove a bigger and potentially more problematic exposure, although market observers have cited logistical impediments to centralizing claims, in addition to the higher hurdles necessary to put-back securities successfully to the banks. Since the majority of subprime and Alt-A originators folded during the crisis, the bulk of the litigation is directed at the underwriters and any large, surviving originators. Thus far, however, subprime and Alt-A repurchase requests have been slow to materialize. Relative to subprime and Alt-A loans, jumbo loans to higher-net borrowers—which were in turn sold to private label investors—have performed substantially better.

Bank of America offers a window into the comparatively slow rate at which private-label securities have been put-back to banks. Between 2004 and 2008, Bank of America sold approximately $750 billion of loans to parties other than the GSEs. As of October 2010, Bank of America received $3.9 billion in repurchase requests from private-label and whole-loan investors. To date, Bank of America has rescinded $1.9 billion in private-label and whole-loan put-back claims and approved $1.0 billion for repurchase, with an estimated loss of $600 million.

This level of actual put-back requests highlights the difficulty in maneuvering the steps necessary to put-back a loan, which begins with a group of investors in the same security or tranche of a security banding together to request access to the underlying loan documents. For example, the group of investors petitioning for paperwork relating to $47 billion in Bank of America loans remain a number of steps away from being in a position to request formally a put-back. Figure 11, below, illustrates the dollar amount of...
or violations. The Federal Reserve Bank of New York also owns private-label RMBS in its Maiden Lane vehicles created under its 13(3) authority.

FRBNY's holdings of private-label RMBS are concentrated in the Maiden Lane II vehicle created as part of the government's intervention in American International Group (AIG). As of June 30, 2010, the fair value of private-label RMBS in Maiden Lane II was $14.8 billion. The sector distribution of Maiden Lane II was 54.6 percent subprime, 30.8 percent Alt-A adjustable rate mortgage (ARM), 6.8 percent option ARM, and the remainder was classified as "other." The $47 billion action that FRBNY joined involves only the private-label RMBS it holds in the Maiden Lane vehicles, and is primarily localized within Maiden Lane II. FRBNY staff conversations with Panel staff (Oct. 26, 2010); Board of Governors of the Federal Reserve System staff conversations with Panel staff (Nov. 10, 2010); Board of Governors of the Federal Reserve System, Federal Reserve Report on Credit and Liquidity Programs and the Balance Sheet, at 19 (Oct. 2010) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201010.pdf) (hereinafter "Federal Reserve Report on Credit and Liquidity Programs and the Balance Sheet"); Board of Governors of the Federal Reserve System, Factors Affecting Reserve Balances (H.4.1) (Nov. 12, 2010) (online at www.federalreserve.gov/releases/h41/); Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release H.4.1). For more information on the Federal Reserve's section 13(3) authority, please see 12 U.S.C. § 343 (providing that the Federal Reserve Board “may authorize any Federal reserve bank . . . to discount . . . notes, drafts, and bills of exchange” for “any individual, partnership, or corporation” if three conditions are met). See also Congressional Oversight Panel, June Oversight Report: The AIG Rescue, Its Impact on Markets, and the Government’s Exit Strategy, at 79–83 (June 10, 2010) (online at cop.senate.gov/documents/cop-061010-report.pdf).

252 There were no sales in 2009. Credit Suisse on Mounting Mortgage Issues, supra note 223.

non-agency loans originated by the nation’s four largest banks between 2005 and 2008.

**FIGURE 11: NON-AGENCY ORIGINATIONS, 2005–2008**

![Graph showing non-agency originations from 2005 to 2008](image_url)

**Put-back Loss Estimates**

Losses stemming from mortgage put-backs are viewed as the biggest potential liability of the banking sector from the foreclosure crisis. While it is difficult to quantify the impact this issue may have on bank balance sheets, a number of analysts have compiled estimates on potential risks to the sector.

The first step in estimating the industry’s exposure is identifying the appropriate universe of loans, within the $10.6 trillion mortgage debt market. The 2005–2008 period is the starting point for this analysis. Of the loans originated during this period, $3.7 trillion were sold by banks to the GSEs and $1.5 trillion were sold to other institutions.
private label investors. Accordingly, this $5.2 trillion in agency and non-agency loans and securities sold by the banks during the 2005–2008 period is the starting point for a series of assumptions—loan delinquencies, put-back requests, successful put-backs, and loss severity—that ultimately drive estimates of potential bank losses.

The Panel has averaged published loss estimates from bank analysts in order to provide a top-level illustration of the cost mortgage put-backs could inflict on bank balance sheets. The estimate below represents a baseline sample of five analyst estimates for the GSE portion and six analyst estimates for the private-label approximation. Accordingly, realized losses could be significantly higher or meaningfully lower.

As outlined below, there are numerous assumptions involved in estimating potential losses from put-backs.

- **Projected Loan Losses**—Delinquent or non-performing mortgage loans provide the initial pipeline for potential mortgage put-backs. Accordingly, estimates of cumulative losses on loans issued between 2005 and 2008 govern the aggregate put-back risk of the banks. The blended estimate for GSE loans is 13 percent, and the blended private label estimate is 30 percent.

- **Gross Put-backs**—The next step is projecting what percentage of these delinquent or nonperforming loans holders will choose to put-back to the banks. The average estimate for gross put-backs for the GSEs is 30 percent, and private label loans is 24 percent.

- **Successful Put-backs**—Of these put-back requests, analysts estimate that 50 percent of GSE loans and 33 percent of private label loans are put-back successfully to the banks.

- **Severity**—The calculation involves the loss severity on loans that are successfully put-back to the banks (i.e., how much the banks have to pay to make the aggrieved investors whole). The blended average severity rate used by analysts for both GSE and the private label loans is 50 percent.

Using the assumptions outlined above, the estimated loss to the industry from mortgage put-backs is $52 billion (see Figure 12).
This range is comprised of a number of base-case or mid-point estimates for potential losses across the industry from put-backs: Standard & Poor's—$43 billion, Deutsche Bank—$43 billion, FBR Capital Markets—$44 billion in potential losses, Citigroup—$50.1 billion, J.P. Morgan—$55 billion, Goldman Sachs—$71 billion, Credit Suisse—$65 billion, The Deutsche Bank estimate is for $31 billion in remaining losses, the $12 billion in realized losses thus far was added to create a consistent metric. FBR on Repurchase-Related Losses, supra note 192; Credit Suisse on Mortgage Put-back Losses, supra note 192; Deutsche Bank Revisits Putbacks and Securitizations, supra note 192; Standard & Poor’s on the Impact of Mortgage Troubles on U.S. Banks, supra note 106, at 4; Citigroup Research Report on Non-Agency Losses, supra note 254; Barclays Capital Research Report on Putbacks and Foreclosures, supra note 254; Goldman Sachs on Assessing the Mortgage Morass, supra note 253.

It is worth noting, however, that Bank of America and JPMorgan Chase are the more meaningful contributors, accounting for approximately 50 percent of the industry’s total projected losses by analysts. Deutsche Bank Revisits Putbacks and Securitizations, supra note 192, at 7; Credit Suisse on Mortgage Troubles on U.S. Banks, supra note 106, at 4; Citigroup Research Report on Non-Agency Losses, supra note 254; FBR on Repurchase-Related Losses, supra note 192.

The estimated $52 billion would be borne predominantly by four firms (Bank of America, JPMorgan Chase, Wells Fargo, and Citigroup), accounting for the majority of the industry’s total exposure and projected losses. In the aggregate these four banks have already reserved $9.9 billion for future representations and warranties expenses, which is in addition to the $11.4 billion in expenses already incurred. Thus, of this potential liability, $21.3 billion has either been previously expensed or reserved for by the major banks. Given the timing associated with put-back requests and associated accounting recognition, it is not inconceivable that the major banks could recognize future losses over a 2–3 year period.

G. Effect of Irregularities and Foreclosure Freezes on Housing Market

1. Foreclosure Freezes and their Effect on Housing

In previous reports, the Panel has noted the many undesirable consequences that foreclosures, especially mass foreclosures, have on individuals, families, neighborhoods, local governments, and the

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<td>2005–2008 MBS Sold</td>
<td>3,651</td>
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<td>13</td>
<td>30</td>
<td>43</td>
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<tr>
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<td>24</td>
<td>166</td>
</tr>
<tr>
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<td>50</td>
<td>33</td>
<td>83</td>
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<td>32</td>
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<td>16</td>
<td>52</td>
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These figures represent the value of the MBS sold either to the GSEs or private-label investors during this period that are still currently outstanding. Nomura Equity Research on Private Label Put-Back Concerns, supra note 253; Goldman Sachs on Assessing the Mortgage Morass, supra note 253.

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economy as a whole. Additionally, housing experts testifying at Panel hearings have emphasized that mass foreclosures cause damage to the economy and social fabric of the country. Certainly, the injection over the past several years of millions of foreclosed-upon homes into an already weak housing market has had a deleterious effect on home prices. These effects are especially relevant in examining what repercussions foreclosure freezes would have on the housing market, and the advisability of such freezes.

Questions remain as to how broadly the current foreclosure irregularities will affect the housing market, and the scale of the losses involved. The immediate effect of the foreclosure document irregularities has been to cause many servicers to freeze all foreclosure processings, although some freezes have been temporary. Some states have encouraged these foreclosure freezes and government-imposed, blanket freezes on all foreclosures have been under discussion. The housing market may not be seriously affected by the current freezes on pending foreclosures, which may actually cause home prices of unaffected homes to rise. Any foreclosure moratorium that is not accompanied by action to address the underlying issues associated with mass foreclosures and the irregularities, however, will add delays but will not provide solutions. Beyond the effects of the current freezes, mortgage documentation irregularities may increase home buyers’ and mortgage investors’ perceptions of risk and damage confidence and trust in the housing market, all of which may drive down home prices.

In considering the possible effects foreclosure freezes may have on the housing market, it is important to distinguish, as the Panel has in previous reports, between the effects these foreclosures and foreclosure freezes may have on individuals versus effects that are more systemic or macroeconomic, as these interests may come into conflict at times. The Panel has also repeatedly acknowledged that the circumstances surrounding some mortgages make foreclosure simply unavoidable. Additionally, the current housing market has, among other difficult problems, a severe oversupply of housing in relation to current demand, which has fallen substantially since the peak bubble years due to higher unemployment and other economic hardships. This fundamental supply/demand imbalance has driven down home prices nationwide, but especially in

262 March 2009 Oversight Report, supra note 6, at 9–11.
263 See, e.g., Written Testimony of Julia Gordon, supra note 171, at 1–2.
264 See, e.g., Statement from Bank of America Home Loans, supra note 21.
266 See, e.g., Reid Welcomes Bank of America Decision, supra note 24; Foreclosure Moratorium: Cracking Down on Liar Liens, supra note 24; Foreclosure Moratorium: Discussing foreclosure freezes: “Again, this raises the question of whether the economic efficiency of foreclosures should be viewed in the context of individual foreclosures or in the context of the macroeconomic impact of widespread foreclosures. If the former, then caution should be exercised about foreclosure moratoria and other forms of delay to the extent it prevents efficient foreclosures. But if the latter is the proper view, then it may well be that some individually efficient foreclosures should nonetheless be prevented in order to mitigate the macroeconomic impact of mass foreclosures.”
267 March 2009 Oversight Report, supra note 6, at 62–63 (Discussing loan modification programs: “As an initial matter, however, it must be recognized that some foreclosures are not avoidable and some workouts may not be economical. This should temper expectations about the scope of any modification program.”).
areas such as Nevada or Florida, where a great many new homes were constructed.\textsuperscript{269}

There are numerous arguments both for and against foreclosure freezes at this time.\textsuperscript{270} Freezing foreclosures may allow time for servicers, state governments, and courts to sort out the irregularity situation and may avoid illegal or erroneous foreclosures in some cases. Voluntary, limited freezes may be sensible for particular servicers. The costs associated with a mandatory foreclosure freeze may also pressure servicers to resolve frozen foreclosures through modifications.\textsuperscript{271} Further, foreclosure freezes can temporarily reduce the number of real estate owned by banks and pre-foreclosure homes coming to market, reducing excess supply, which can be beneficial for home prices in the short term. The longer-term consequences of freezes depend on the ultimate solution to the issues giving rise to the freezes.

In addition, foreclosures have many well-documented negative financial and social consequences on families and neighborhoods that might be mitigated by a foreclosure freeze.\textsuperscript{272} Vacant homes can attract thieves and vandals. If not maintained by the lender, properties foreclosed upon and repossessed by the lender—properties also known as real-estate owned (REOs), often become eyesores, detracting from the appearance of the neighborhood and reducing local home values. The drop in the value of neighboring homes has been corroborated by a recent study. Although the authors found that the impact of foreclosed homes on each individual neighboring home is relatively small, these losses can amount to a considerable total loss in value to the neighborhood. Not surprisingly, the researchers found a more dramatic decline in value for the foreclosed home itself. The study indicated that foreclosure lowers a home’s value by an average of 27 percent, much more than other events, such as personal bankruptcy, that also lead to forced home sales. The researchers attribute these losses primarily to the urgency with which lenders dispose of REOs and to damage inflicted on vacant, lender-owned homes.\textsuperscript{273}

In addition to lowering the value of the home itself, a foreclosure affects the surrounding neighborhood, especially if the home is clearly marked with a sale sign that says “foreclosure.” A reduction in price from a foreclosed property can affect the values of surrounding homes if the low price is used as a comparable sale for valuation purposes. Even if foreclosure sales are excluded as com-

\textsuperscript{269} The oversupply of homes can be clearly seen from “for sale” inventory statistics, which the Panel has discussed in previous reports. See, e.g., March 2009 Oversight Report, supra note 6, at 107–108. September 2010 for-sale housing inventory stands at 4.94 million homes, a 10.7 month supply at current sales rates, up from the 3.59 million homes representing an 8.6 month supply cited in the Panel’s April report on foreclosures. National Association of Realtors, September Existing-Home Sales Show Another Strong Gain (Oct. 25, 2010) (online at www.realtor.org/press_room/news_releases/2010/10/sept_strong).

\textsuperscript{270} The Panel has discussed some of the pros and cons of foreclosure freezes in prior reports, but not in the context of the irregularities. March 2009 Oversight Report, supra note 6, at 61–63.

\textsuperscript{271} March 2009 Oversight Report, supra note 6, at 61.

\textsuperscript{272} See, e.g., March 2009 Oversight Report, supra note 6, at 9–11.

\textsuperscript{273} John Campbell, Stefano Giglio, and Parag Pathak, Forced Sales and House Prices, at 10, 18, 21. Unpublished manuscript (July 2010) (online at econ-www.mit.edu/files/5694) (“...the typical foreclosure during this period lowered the price of the foreclosed house by $44,000 and the prices of neighboring houses by a total of $477,000, for a total loss in housing value of $520,000.” and “Our preferred estimate of the spillover effect suggests that each foreclosure that takes place 0.05 miles away lowers the price of a house by about 1%.”).
parable sales from appraisals, as is often the case, these sale prices are readily accessible public information. For example, considering the popularity of real estate sites such as Zillow and Trulia that show home sale prices, buyers can easily see these low foreclosure sale prices and are likely to reduce their offers accordingly. Furthermore, as Julia Gordon of the Center for Responsible Lending and several academic studies observe, minority communities are disproportionately affected by foreclosures and their consequences. These negative externalities from foreclosures are borne not by any of the parties to the mortgage, but by the neighbors and the community, who are innocent bystanders.

One of the most common arguments against foreclosure freezes concerns the effect that freezes could have on shadow inventory—properties likely to be sold in the near future that are not currently on the market, and are therefore not counted in supply inventory statistics. A prolonged freeze on foreclosures without a diminution in the number of homes in foreclosure would add to the already substantial problem of shadow inventory. Of course, increased shadow inventory can be addressed either by foreclosing and selling homes, or by creating circumstances that allow current homeowners to stay in their homes. Although there are no reliable measures (or definitions) of shadow inventory, estimates range from 1.7 million to 7 million homes. These homes represent additional supply that the market will eventually have to accommodate, so long as the homes are not removed from the shadow inventory due to circumstances such as loan modifications or an improvement in the financial condition of borrowers.

Beyond shadow inventory, foreclosure sales consist of sales of homes immediately prior to foreclosure and sales of REOs. In the 12 months between September 2009 and August 2010, 4.13 million existing homes were sold in the United States, approximately 30

274 Zillow does not include foreclosure data in its home price estimates; however, a person can click on a home, including foreclosed homes, and see its sales price.
276 Congressional Oversight Panel, Testimony of Julia Gordon, senior policy council, Center for Responsible Lending, Transcript: COP Hearing on TARP Foreclosure Mitigation Programs (Oct. 27, 2010) (publication forthcoming) (online at cop.senate.gov/hearings/library/hearing-102710-foreclosure.cfm) (“African American and Latino families are much more likely than whites to lose their homes, and we estimate that communities of color will lose over $360 billion worth of wealth.”).
277 First American CoreLogic, “Shadow Housing Inventory” Put At 1.7 Million in 3Q According to First American CoreLogic (Dec. 17, 2009) (online at www.corelogic.com/uploadedFiles/News-Room/RES in the News/FACL Shadow Inventory 121809.pdf); Laurie Goodman, Robert Hunter, et al., Amherst Securities Group LP, Amherst Mortgage Insight: Housing Overhang/Shadow Inventory = Enormous Problem, at 1 (Sept. 23, 2009) (online at matrix.millerssamuel.com/wp-content/3q09/Amherst%20Mortgage%20Insight%202009232009.pdf).
278 James J. Saccacio, chief executive officer of the online foreclosure marketplace RealtyTrac, expects that “if the lenders can resolve the documentation issue quickly, then we would expect the temporary halt in foreclosure activity to be followed by a parallel spike in activity as many of the delayed foreclosures move forward in the foreclosure process. However, if the documentation issue cannot be quickly resolved and expands to more lenders then we can see a chilling effect on the overall housing market as sales of pre-foreclosure and foreclosed properties, which account for nearly one-third of all sales, dry up and the shadow inventory of distressed properties grows—causing more uncertainty about home prices.” RealtyTrac, Foreclosure Activity Increases 4 Percent in Third Quarter (Oct. 14, 2010) (online at www.realtytrac.com/content/press-releases/q3-2010-and-september-2010-foreclosure-reports-6108) (hereinafter “RealtyTrac Press Release on Foreclosure Activity”).
percent of which were foreclosure sales.279 Further, lenders are estimated to own 290,000 properties as REOs.280 Currently, approximately 2 million homes, or 4.6 percent of all mortgaged properties, are classified as in the foreclosure process. Another 2 million, or 4.5 percent of mortgaged properties, are more than 90 days past due.281 The level of foreclosures is, further, expected to rise: more than $1 trillion in adjustable-rate mortgages are expected to experience interest rate resets between 2010 and 2012, an event that is positively correlated with delinquency and foreclosure.282 Foreclosure sales therefore represent a very substantial portion of housing market activity, with many more foreclosures either in the pipeline or likely to enter the pipeline in the coming years.

Opponents of mandatory foreclosure freezes have also argued that a widespread freeze would encourage defaults by eliminating the negative consequences of default; that foreclosure freezes are bad for mortgage investors (including taxpayers, as owners of the GSEs);283 because they reduce investment returns by delaying the payment of foreclosure sale proceeds; and that they would disproportionately harm smaller banks and credit unions, which are heavily invested in home mortgages.284 Further, when smaller banks and credit unions service loans, payments to investors on non-performing loans must come from significantly smaller cash cushions than they do for the largest banks and servicers.285 James Lockhart, former regulator of Fannie Mae and Freddie Mac, has stated that freezes will also extend the time that homes in foreclosure proceedings will be left vacant, with attendant negative ef-


280 RealtyTrac Press Release on Foreclosure Activity, supra note 278.

281 MBA National Delinquency Survey, Q2 2010, supra note 199. See also MBA Press Release on Delinquencies and Foreclosure Starts, supra note 199.


283 Fannie Mae and Freddie Mac would be impacted directly by a freeze because they would have to continue advancing coupon payments to bondholders while not receiving any revenue from disposal of foreclosed properties, upon which they are already not receiving mortgage payments. These costs would almost certainly be borne by taxpayers, and depending on the duration of the freeze and how the housing market responds to it, they could be substantial. Press reports and Panel staff discussions with industry sources have indicated that, as part of an effort to restart foreclosures, Fannie Mae and Freddie Mac were until recently negotiating an indemnification agreement with servicers and title insurers. This would have been along the lines of the recent agreement between Bank of America and Fidelity National Financial, mentioned above in Section C, in which Bank of America agreed to indemnify Fidelity National (a title insurer) for losses incurred due to servicer errors. However, industry sources stated that the GSEs had recently cooled to this effort. Industry sources conversations with Panel staff (Nov. 9, 2010); Nick Timiraos, Fannie, Freddie Seek End to Freeze, Wall Street Journal (Oct. 23, 2010) (online at online.wsj.com/article/ SB1000142405270230435410457556862129952944.html); see also Statement from Bank of America Home Loans, supra note 16.

284 Third Way Domestic Policy Memo on the Case Against a Foreclosure Moratorium, supra note 227.

285 See Section F.2, supra.
fects on the surrounding neighborhood. Such cases would presumably involve already vacant, foreclosed-upon homes, and homes with impending or ongoing foreclosure proceedings where the borrower has chosen to vacate early, as occasionally happens.

2. Foreclosure Irregularities and the Crisis of Confidence

The apparently widespread nature of the foreclosure irregularities that have come to light has the potential to reduce public trust substantially in the entire real estate industry, especially in the legitimacy of important legal documents and the good faith of other market participants. Under these circumstances, either buying or lending on a home will appear to be substantially more risky than before. If buyers suspect that homes, especially foreclosed homes, may have unknown title and legal problems, they may be less likely to buy, or at least they may lower their offers to account for the increased risks. Since foreclosure sales currently account for such a large portion of market activity, in the absence of solutions that reduce foreclosures, a reduction in demand for previously foreclosed-upon properties would have negative effects on the overall housing market. David Stevens, commissioner of the Federal Housing Administration, recently noted that the mortgage industry now faces an “enormous trust deficit” that risks “scaring” off an entire generation of young people from homeownership.

Similar dynamics may impact the availability and cost of mortgages as well, as mortgage investors, who provide the capital that ultimately supports home prices, reassess their perceptions of risk. The exposure of foreclosure irregularities has raised a host of potential risks for investors, such as the possibility that MBS trusts may not actually own the underlying loans they claim to own, that servicers may not be able to foreclose upon delinquent borrowers and thus recover invested capital, that borrowers who have already been foreclosed upon may sue, or that other currently unknown liability issues exist. These new risks could cause some mortgage investors to look for safer alternative investments or to increase their investment return requirements to compensate for the increased risks. With wary investors making less capital available for mortgages, and reevaluating the risk of residential lending, mortgage interest rates could rise, in turn decreasing the affordability of homes and depressing home prices, as the same monthly payment now supports a smaller mortgage.

Additionally, both the foreclosure freezes and the legal wrangling between homeowners, servicers, title companies, and investors that appears inevitable at this point, and in the absence of a solution to the problem of mass foreclosures could extend the time it will


287 JPMorgan Chase estimates that approximately one-third of the homes upon which it forecloses are already vacant by the time the foreclosure process commences. Stephen Meister, Foreclosuregate is Quickly Spinning Out of Control, RealClearMarkets (Oct. 22, 2010) (online at www.realclearmarkets.com/articles/2010/10/22/foreclosuregate_is_quickly_spinning_out_of_control.html). Similarly, there are reports about a type of strategic default, commonly known as “jingle mail,” where the delinquent borrower vacates the home and mails the servicer the keys in the hope that the servicer will accept the act as a deed-in-lieu-of-foreclosure, or simply to get the foreclosure process over with.

take for the inventory of homes for sale to be cleared from the system, and thus could potentially delay the recovery of the housing market.\footnote{Cf. The White House, Press Briefing (Oct. 12, 2010) (online at www.whitehouse.gov/the-press-office/2010/10/12/press-briefing-press-secretary-robert-gibbs-10122010) ("We also have pointed out, though, that the idea of a national moratorium would impact the recovery in the housing sector, as anybody that wished to enter into a contract or execute a contract to purchase a home that had previously been foreclosed on, that process stops. That means houses and neighborhoods remain empty even if there are buyers ready, willing and able to do so.").} Further, general uncertainty about the scope of these problems and how they will be addressed by market participants and governments could have a chilling effect on both home sales and mortgage investment, as people adopt a “wait and see” attitude. On the other hand, some delay could be beneficial in that it would provide the time necessary to arrive at a more comprehensive solution to the many complex issues involved in, or underlying, this situation.\footnote{In prior reports, the Panel has acknowledged that the delays caused by foreclosure freezes create additional costs for servicers, but also have possibly beneficial effects for borrowers. March 2009 Oversight Report, supra note 6, at 61–63.}

The recent and developing nature of the foreclosure irregularities means that predicting their effects, as well as those of any resulting foreclosure freezes, on the housing market necessarily involves a high degree of speculation. Actual housing market movements will depend on, among other things, the scope and severity of the foreclosure irregularities, the resolution of various legal issues, government actions, and on the reactions of homeowners, home buyers, servicers, and mortgage investors. It seems clear, however, that the many unknowns, uncertain solutions, and potential liability for fraud greatly add to the risk inherent in owning or lending on affected homes.\footnote{Mortgage lenders who make loans on formerly foreclosed homes where the legal ownership of the property is uncertain due to foreclosure irregularities risk the possibility that other creditors could come forward with competing claims to the collateral.}

\section*{H. Impact on HAMP}

HAMP is a nationwide mortgage modification program established in 2009, using TARP funds, as an answer to the growing foreclosure problem. HAMP is designed to provide a mortgage modification to homeowners in those cases in which modification, from the perspective of the mortgage holder, is an economically preferable outcome to foreclosure. The program provides financial incentives to servicers to modify mortgages for homeowners at risk of default, and incentives for the beneficiaries of these modifications to stay current on their mortgage payments going forward.\footnote{Servicers of GSE mortgages are required to participate in HAMP for their GSE portfolios. Servicers of non-GSE mortgages may elect to sign a Servicer Participation Agreement in order to participate in the program. Once an agreement has been signed, the participating servicer must evaluate all mortgages under HAMP unless the participation contract is terminated. See Congressional Oversight Panel, October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months, at 44–45 (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report.pdf).} Participation in the program by servicers is on a voluntary basis. Once a servicer is in HAMP, though, if a borrower meets certain eligibility criteria, participating servicers must run a test, known as a net present value (NPV) test, to evaluate whether a foreclosure or a loan modification would yield a higher value. If the value of the modified mortgage is greater than the potential fore-
Treasury asserts that the foreclosure irregularities have no direct impact on HAMP. With regard to false affidavits, Phyllis Caldwell, chief of Treasury’s Homeownership Preservation Office, noted that HAMP is a foreclosure-prevention program and therefore is separate from the actual foreclosure sale process. As a result, HAMP “is not directly affected by ‘robo-signers’ or false affidavits filed with state courts.”

With regard to the issues around the transfer of ownership of the mortgage, Ms. Caldwell testified that “to modify a mortgage, there is not a need to have clear title.” In addition, Treasury stated that it has not reviewed mortgage ownership transfers because the modifications are private contracts between the servicer and the borrower. Perhaps as a result, Treasury is not doing anything independently to determine if the mortgages the servicers in HAMP are modifying have been properly transferred into the trusts the servicers represent. It is supporting other agencies in their efforts, but is taking no action on its own. According to Ms. Caldwell, there is an “assumption that the servicer is following the laws. [ . . .] If we learn something after the fact that contradicts that, we do have the ability to go in and claw back the incentive.” Treasury echoed this opinion in conversations with Panel staff.

The Panel questions Treasury’s position that HAMP is unaffected by the foreclosure irregularities. Although it is difficult to assess the exact consequences of the foreclosure documentation crisis on HAMP at this point, there are several strong potential links which Treasury should carefully consider. For example, if trusts have not properly received ownership of the mortgage, they may not be the legal owner of the mortgage. If the trust does not own the mortgage, the servicer cannot foreclose on it, and HAMP, a foreclosure prevention program, is paying incentives to parties with no legal right to foreclose. At present, Treasury has no way to determine if such payments are being made. Treasury may well be paying incentives to servicers that have no right to receive them.

Treasury has justified its relative inaction by noting that if ownership of the mortgage has not been properly transferred, the legal

293 Written Testimony of Phyllis Caldwell, supra note 142, at 1.
294 Testimony of Phyllis Caldwell, supra note 143.
295 Treasury conversations with Panel staff (Oct. 21, 2010).
296 Testimony of Phyllis Caldwell, supra note 143 ("KAUFMAN: So you’re not sending anyone out to actually find out whether they hold the mortgages? . . . Or any kind of physical (ph) follow-up on the fact that there are mortgages out there—do they actually have the mortgages and they actually have title to the land that they are trying to foreclose on? CALDWELL: At this point, we are supporting all of the agencies that are doing investigations of those servicers, including the GSEs, and are monitoring closely, and will take follow-up action when there are facts that we get from those reviews. KAUFMAN: So . . . Treasury’s not doing anything independently to determine that mortgages modified under HAMP have all necessary loan documentation and a clear chain of title? . . . CALDWELL: . . . I think that . . . it’s an important issue and something that . . . at least at this point in time . . . we’re looking at the foreclosure prevention process separate from the actual foreclosure sale process. And to modify a mortgage, there is not a need to have clear title. . . . you need information from the note, but you don’t need a physical note to modify a mortgage."). See also Treasury conversations with Panel staff (Oct. 21, 2010).
297 Testimony of Phyllis Caldwell, supra note 143.
298 Treasury conversations with Panel staff (Oct. 21, 2010).
299 Testimony of Phyllis Caldwell, supra note 143.
owner will eventually appear, and at that time, Treasury can claw back any incentive payments made to the wrong party.300 Such a solution, however, may not be feasible. It optimistically assumes that legal owners will be able to identify clearly the mortgages they own, despite all of the potential litigation and complex transactions many mortgages have been part of, and then navigate the bureaucracy to bring the matter before Treasury. Inevitably, not all legal owners will manage this, in which case Treasury will be giving money to parties that are not entitled to it. Moreover, if this is occurring, even in cases where the legal owners do come forward, Treasury is essentially providing interest-free loans to the wrong parties in the meantime. In addition, Treasury’s inactivity may give rise to a double standard in which borrowers must provide extensive documentation before benefiting from HAMP, while servicers are allowed public money without having to prove their right to foreclose.

In addition, although Treasury maintains that HAMP is unaffected by transfer of mortgage ownership issues because modifications are private contracts between servicers and borrowers,301 a servicer cannot modify a loan unless it is authorized to do so by the mortgage’s actual owner.302 If legal owners then begin to come forward, as Treasury is relying on them to do in order to clarify incentive payments, the legal owners will not be bound by the modifications.303 Abruptly, borrowers would no longer benefit from the reduced interest rates of a HAMP modification. As a result, the length of time that a modification provides a borrower to recover and become current on payment, which Treasury cites as one of HAMP’s principal successes,304 would be cut short. Indeed, borrowers may even suffer penalties for not having been paying the monthly payments required prior to the modification.

Another concern involves how HAMP servicers have been calculating the costs of foreclosure under the program’s NPV test. Foreclosures carry significant costs leading up to the acquisition of a property’s title. If, by cutting corners in the foreclosure process, servicers were able to lower the cost of foreclosure artificially, their own internal cost comparison analysis might have differed from the official NPV analysis. In such instances, servicers would have an incentive to lose paperwork or otherwise deny modifications that they would be compelled to make under the program standards. Conversely, foreclosure irregularities could have the perverse effect of encouraging servicers to modify more loans through HAMP. If foreclosure irregularities lead to additional litigation and delays in foreclosure proceedings, they will increase the costs of foreclosure.305 Treasury may then update the HAMP NPV model to reflect these new realities. With the costs of foreclosure higher, the

300 Treasury conversations with Panel staff (Oct. 21, 2010).
301 Treasury conversations with Panel staff (Oct. 21, 2010).
302 Written Testimony of Katherine Porter, supra note 14, at 8.
303 It is unclear what would happen if the true owner were also in HAMP. Under the HAMP standards, the individual servicer should not matter, and a loan that qualified for a modification with one servicer should qualify with another. The borrower, however, might have to reapply for a modification and enter a new trial modification. It is also possible that Treasury could facilitate the transfer and not require a borrower to reapply.
304 Testimony of Phyllis Caldwell, supra note 143.
305 See Sections D and F, supra.
NPV model will find more modifications to be NPV-positive, resulting in more HAMP modifications.

I. Conclusion

Allegations of documentation irregularities remain in flux, and their consequences remain uncertain. The best-case scenario, a possibility embraced by the financial services industry, is that current concerns over foreclosure irregularities are overblown, reflecting mere clerical errors that can and will be resolved quickly. If this view proves correct, then the irregularities might be fixed with little to no impact on HAMP or financial stability.

The worst-case scenario, a possibility predominantly articulated by homeowners and plaintiffs’ lawyers, is considerably grimmer. In this view, the irregularities reflect extensive misbehavior on the part of banks and loan servicers that extends throughout the entire securitization process. Such problems could throw into question the enforceability of legal rights related to ownership of many loans that have been pooled and securitized. Given that 4.2 million homeowners are currently in default and facing potential foreclosure, including 729,000 who have been rejected from HAMP, the implications for the foreclosure market alone would be immense. Much larger, of course, would be the implications of such irregularities for the broader market in MBS, which totals $7.6 trillion in value. Losses related to documentation issues could be compounded by losses related to MBS investors exercising put-back rights due to poor underwriting of securitized loans.

Several investigations of irregularities are now underway, including a review by the 50 states’ attorneys general; an investigation by the Federal Fraud Enforcement Task Force; an effort to review documentation for certain Countrywide loans led by PIMCO, BlackRock, and FRBNY; and numerous other inquiries by private investors. These and similar efforts may ultimately uncover the full extent of irregularities in mortgage loan originations, transfers, and foreclosures, but the final picture may not emerge for some time if these actions founder in protracted litigation.

In the meantime, the Panel raises several concerns that policymakers should carefully consider as these issues evolve.

Treasury Should Monitor Closely the Impact of Foreclosure Irregularities. Treasury so far has expressed relatively little concern that foreclosure irregularities could reflect deeper problems that would pose a threat to financial stability. According to Phyllis Caldwell, Chief of the Homeownership Preservation Office for Treasury, “We’re very closely monitoring any litigation risk to see if there is any systemic threat, but at this point, there’s no indication that there is [any threat].” This statement appears premature. Potential threats are by definition those that have not yet fully materialized, but their risks remain real. Despite assurances by banks and Treasury to the contrary, great uncertainty remains as to whether the stability of banks and the housing market might be at risk if the legal underpinnings of the real estate market should come into question. Treasury should closely monitor these issues as they develop, both for the sake of its foreclosure mitigation programs and for the overall health of the banking system, and Treasury should report its findings to the public and to Con-
gress. Further, Treasury should develop contingency plans to prepare for the potential worst-case scenario.

**Treasury and the Federal Reserve Should Stress Test Banks to Evaluate Their Ability to Weather a Crisis Related to Mortgage Irregularities.** The potential for further instability among the largest banks raises the specter of another acute crisis like the one that hit the markets in the autumn of 2008. If investors come to doubt the entire process underlying securitizations, they may grow unwilling to lend money to even the largest banks without implicit or explicit assurances that taxpayers will bear any losses. Further, banks could, in the worst-case scenario, suffer severe direct capital losses due to put-backs. Bank of America holds $230.5 billion in equity, yet the PIMCO and FRBNY action alone could ultimately seek up to $47 billion in put-backs. If several similar-sized actions were to succeed, Bank of America could suffer a major dent in its regulatory capital. In effect, a bank forced to accept put-backs would be required to buy back troubled mortgage loans that in many cases had already defaulted or had been poorly underwritten. As the Panel has noted in the past, some major banks have had extensive exposure to troubled mortgage-related assets. Widespread put-backs could destabilize financial institutions that remain exposed and could lead to a precarious situation for those that were emerging from the crisis. Further, banks and loan servicers could be vulnerable to state-based class-action lawsuits initiated by homeowners who claim to have suffered improper foreclosures. Even the prospect of such losses could damage a bank’s stock price or its ability to raise capital.

The Panel has recommended in the past that, when policymakers are faced with uncertain economic or financial conditions, they should employ “stress tests” as part of the regular bank supervisory process to identify possible outcomes and to measure the robustness of the financial system. Treasury and the Federal Reserve last conducted comprehensive stress tests in 2009, but because those tests predated the current concerns about documentation irregularities and projected banks’ capitalization only through the end of 2010, they offer limited reassurance that major banks could survive further shocks in the months and years to come. Federal banking regulators should re-run stress tests on the largest banks and on at least a sampling of smaller institutions, using realistic macroeconomic and housing price projections and stringent assumptions about realistic worst-case scenario bank losses. Any assumptions about the ultimate costs of documentation irregularities would be necessarily speculative and the contours of the problem are still murky. Stress tests may therefore need to account for a wide range of possibilities and acknowledge their own limitations. Such testing, however, would nonetheless illuminate the robustness of the financial system and help prepare for a worst-case scenario.

**Policymakers Should Evaluate System-Wide Consequences of Documentation Irregularities.** As disturbing as the potential implications of documentation irregularities may be for “too big to fail” banks, the consequences would not be limited to the largest banks in the market. Among other concerns:

- **Fannie Mae and Freddie Mac Present Significant Risks.**
  Already Fannie Mae and Freddie Mac play an enormous role
in the market for MBS. If investors develop new concerns about the safety of the MBS market, then Fannie and Freddie—backed by their government guarantee—could be forced to maintain or even expand their dominant role for years to come. Because the American people ultimately stand behind every guarantee made by these companies, the result could be greater and prolonged financial risk to taxpayers.

- **Homeowners May Lose Confidence in the Housing Market.** Buyers and sellers, in foreclosure or otherwise, may find themselves unable to know with any certainty whether they can safely buy or safely sell a home. Widespread loss of confidence in clear ownership of mortgage loans would throw further sand in the gears of the already troubled housing market—especially since 31 percent of the homes currently on the market are foreclosure sales, which may already have undergone an improper legal process.

- **Public Faith in Due Process Could Suffer.** If the public gains the impression that the government is providing concessions to large banks in order to ensure the smooth processing of foreclosures, the people's fundamental faith in due process could suffer.

In short, actions by some of the largest financial institutions may have the potential to threaten the still-fragile economy. The risk is uncertain, but the danger is significant enough that Treasury and all other government agencies with a role to play in the mortgage market must focus on preventing another such shock.
SECTION TWO: CORRESPONDENCE WITH TREASURY

The Panel’s Chairman, Senator Ted Kaufman, sent a letter on behalf of the Panel on November 1, 2010 to Patricia Geoghegan, the Special Master for TARP Executive Compensation under EESA. The letter presents a series of questions to the Special Master, requesting additional information and data following the Panel’s October 21, 2010 hearing on TARP and executive compensation.

See Appendix I of this report, infra.
SECTION THREE: TARP UPDATES SINCE LAST REPORT

A. GM To Repurchase AIFP Preferred Stock

On October 27, 2010, Treasury accepted an offer by General Motors Company (New GM) to repurchase 83.9 million shares of New GM's Series A preferred stock at $25.50 per share provided that the company's proposed initial public offering (IPO) is completed. These preferred shares were issued, along with 60.8 percent of the company's common stock, in July 2009 in exchange for extinguishing the debtor-in-possession loan extended to General Motors Corporation (Old GM). The repurchase price represents 102 percent of the liquidation preference. After the IPO is completed, New GM will repurchase the Series A preferred shares on the first dividend payment date of the preferred stock. Following this transaction, Treasury's total return from New GM through debt repayments, the preferred stock repurchase, and interest and dividends will total $9.5 billion.

B. AIG: AIA Initial Public Offering and ALICO Sale

As part of its plan to repay the federal government's outstanding investments, AIG completed an IPO for AIA Group Limited (AIA) and sold American Life Insurance Company (ALICO) to MetLife, Inc. The AIA IPO raised $20.5 billion in cash proceeds and the ALICO sale generated $16.2 billion in total proceeds. Of this amount, $7.2 billion represents cash proceeds. The $36.7 billion in aggregate proceeds will be used to pay down the outstanding balance on the revolving credit facility from FRBNY.

C. Sales of Citigroup Common Stock

On October 19, 2010, Treasury began a fourth period of sales for 1.5 billion shares of Citigroup common stock. Treasury received 7.7 billion common shares in July 2009 in exchange for its initial $25 billion investment in the company under the CPP. As of October 29, 2010, Treasury has sold 4.1 billion shares (approximately fifty percent of its stake) for $16.4 billion in gross proceeds. Of this amount, approximately $13.4 billion represents a repayment for Citigroup's CPP funding, while the remaining $3 billion represents a net profit for taxpayers. Morgan Stanley will act as Treasury's sales agent for the fourth selling period, which will end on December 31, 2010 or upon the sale of the full allotment of 1.5 billion shares.

D. Legacy Securities Public-Private Investments Program Quarterly Report

On October 20, 2010, Treasury released its fourth quarterly report on the Legacy Securities Public-Private Investments Program (PPIP). This program is intended to support market functioning and facilitate price discovery in MBS markets through equity and debt capital commitments in eight public-private investment funds (PPIFs). As of September 30, 2010, the purchasing power of these
funds totaled $29.4 billion. Of this amount, $7.4 billion represents equity commitments from private-sector fund managers and investors and $22.1 billion represents both debt and equity commitments from Treasury. The total market value of securities held by participating PPIIFs was approximately $19.3 billion, with 82 percent of investments concentrated in non-agency RMBS and 18 percent in commercial mortgage-backed securities (CMBS).

To date, cumulative gross unrealized equity gains for both Treasury and private investors total $1.5 billion. The net internal rate of return for each PPIIF is currently between 19.3 percent and 52.0 percent.

E. Metrics

Each month, the Panel’s report highlights a number of metrics that the Panel and others, including Treasury, the Government Accountability Office (GAO), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration’s efforts to restore financial stability and accomplish the goals of EESA. This section discusses changes that have occurred in several indicators since the release of the Panel’s October 2010 report.

1. Macroeconomic Indices

The post-crisis rate of real GDP growth quarter-over-quarter peaked at an annual rate of 5 percent in the fourth quarter of 2009, but the rate has decreased during 2010. Real GDP increased at an annualized rate of 2.0 percent in the third quarter of 2010, increasing from 1.7 percent in the second quarter of 2010. The third quarter growth rate was unaffected by the spike in employment resulting from the 2010 U.S. Census. The year-over-year increase from third quarter 2009 to third quarter 2010 was 3.1 percent, from 12.9 billion to 13.3 billion dollars.
Since the Panel’s October report, underemployment has increased from 16.7 percent to 17.1 percent, while unemployment has remained constant. Median duration of unemployment has increased by half a week.

Bureau of Economic Analysis Table 1.1.6, supra note 308 (accessed Nov. 3, 2010).

It is important to note that the measures of unemployment and underemployment do not include people who have stopped actively looking for work altogether. While the Bureau of Labor Statistics (BLS) does not have a distinct metric for “underemployment,” the U–6 category of Table A–15 “Alternative Measures of Labor Underutilization” is used here as a proxy. BLS defines this measure as: “Total unemployed, plus all persons marginally attached to the labor force, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all persons marginally attached to the labor force.” U.S. Department of Labor, International Comparisons of Annual Labor Force Statistics (online at www.bls.gov/webapps/legacy/cpsatab15.htm) (accessed Nov. 3, 2010).
2. Financial Indices
   
a. Overview
   
Since the Panel’s October report, the St. Louis Financial Stress Index, a proxy for financial stress in the U.S. economy, has continued its downward trend, decreasing by a quarter.\footnote{Federal Reserve Bank of St. Louis, Series STLFSI: Business/Fiscal: Other Economic Indicators (Instrument: St. Louis Financial Stress Index, Frequency: Weekly) (online at research.stlouisfed.org/fred2/series/STLFSI) (accessed Nov. 3, 2010). The index includes 18 weekly data series, beginning in December 1993 to the present. The series are: effective federal funds rate, 2-year Treasury, 10-year Treasury, 30-year Treasury, Baa-rated corporate, Merrill Lynch High Yield Corporate Master II Index, Merrill Lynch Asset-Backed Master BBB-rated, 10-year Treasury minus 3-month Treasury, Corporate Baa-rated bond minus 10-year Treasury, Merrill Lynch High Yield Corporate Master II Index minus 10-year Treasury, 3-month LIBOR-OIS spread, 3-month TED spread, 3-month commercial paper minus 3-month Treasury, the J.P. Morgan Emerging Markets Bond Index Plus, Chicago Board Options Exchange Market Volatility Index, Merrill Lynch Bond Market Volatility Index (1-month), 10-year nominal Treasury yield minus 10-year Treasury Inflation Protected Security yield, and Vanguard Financials Exchange-Traded Fund (equities). The index is constructed using principal components analysis after the data series are de-meaned and divided by their respective standard deviations to make them comparable units. The standard deviation of the index is set to 1. For more details on the construction of this index, see Federal Reserve Bank of St. Louis, National Economic Trends Appendix: The St. Louis Fed’s Financial Stress Index (Jan. 2010) (online at research.stlouisfed.org/publications/net/NETJan2010Appendix.pdf).} The index has fallen by over half since the post-crisis peak in June 2010. The recent trend in the index suggests that financial stress continues moving toward its long-run norm. The index has decreased by more than three standard deviations since October 2008, the month when the TARP was initiated.

\begin{figure}[h]
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\caption{St. Louis Federal Reserve Financial Stress Index}
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Stock market volatility has decreased recently. The Chicago Board Options Exchange Volatility Index (VIX) has fallen by more than half since the post-crisis peak in May 2010 and has fallen 7 percent since the Panel’s October report. However, volatility is still 40 percent higher than its post-crisis low on April 12, 2010.
b. Interest Rates, Spreads, and Issuance

As of November 3, 2010, the 3-month and 1-month London Interbank Offer Rates (LIBOR), the prices at which banks lend and borrow from each other, were 0.29 and 0.25, respectively. Rates have fallen by nearly half since post-crisis highs in June 2010 and have remained nearly constant since the Panel’s October report. Over the longer term, however, interest rates remain extremely low relative to pre-crisis levels, indicating both efforts of central banks and institutions’ perceptions of reduced risk in lending to other banks.

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<td>3-Month LIBOR</td>
<td>0.29</td>
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<td>1-Month LIBOR</td>
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Since the Panel’s October report, interest rate spreads have decreased slightly. Thirty-year mortgage interest rates have decreased very slightly and 10-year Treasury bond yields have increased very slightly. The conventional mortgage spread, which measures the 30-year mortgage rate over 10-year Treasury bond yields, has decreased slightly since late September.

The TED spread serves as an indicator for perceived risk in the financial markets. While it has increased by about three basis points since the Panel’s October report, the spread is still currently
lower than pre-crisis levels. The LIBOR–OIS spread reflects the health of the banking system. While it increased over threefold from early April to July, it has been falling since mid-July and is now averaging pre-crisis levels. LIBOR–OIS remained fairly constant since the Panel's October report. Decreases in the LIBOR–OIS spread and the TED spread suggest that hesitation among banks to lend to counterparties has receded.

FIGURE 18: TED SPREAD

The interest rate spread for AA asset-backed commercial paper, which is considered mid-investment grade, has fallen by more than a tenth since the Panel's October report. The interest rate spread

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319 Data accessed through Bloomberg data service on November 3, 2010.
320 Data accessed through Bloomberg data service on November 3, 2010.
on A2/P2 commercial paper, a lower grade investment than AA asset-backed commercial paper, has fallen by nearly 11 percent since the Panel's October report. This indicates healthier fundraising conditions for corporations.

FIGURE 20: INTEREST RATE SPREADS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Conventional mortgage rate spread</td>
<td>1.56</td>
<td>(13.3)</td>
</tr>
<tr>
<td>TED Spread (basis points)</td>
<td>15.59</td>
<td>20.0</td>
</tr>
<tr>
<td>Overnight AA asset-backed commercial paper interest rate spread</td>
<td>0.07</td>
<td>(11.2)</td>
</tr>
<tr>
<td>Overnight A2/P2 nonfinancial commercial paper interest rate spread</td>
<td>0.14</td>
<td>(11.0)</td>
</tr>
</tbody>
</table>

The spread between Moody’s Baa Corporate Bond Yield Index and 30-year constant maturity U.S. Treasury Bond yields doubled from late April to mid-June 2010. Spreads have trended down since mid-June highs and have fallen over 6 percent since the Panel’s October report. This spread indicates the difference in perceived risk between corporate and government bonds, and a declining spread could indicate waning concerns about the riskiness of corporate bonds.
c. Condition of the Banks

Since the Panel’s last report, 10 additional banks have failed, with an approximate total asset value of $4.2 billion. With 139 failures from January through October 2010, the year-to-date rate has nearly reached 140, the level for all of calendar year 2009. In general, banks failing in 2009 and 2010 have been small- and medium-sized institutions; while they are failing in high numbers, their aggregate asset size has been relatively small.
The disparity between the number of and total assets of failed banks in 2008 is driven primarily by the failure of Washington Mutual Bank, which held $307 billion in assets. The 2010 year-to-date percentage of bank failures includes failures through August. The total number of FDIC-insured institutions as of March 31, 2010 is 7,932 commercial banks and savings institutions. As of November 12, 2010, there have been 143 institutions that failed. Federal Deposit Insurance Corporation, Failures and Assistance Transactions (online at www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30) (accessed Nov. 12, 2010). Asset totals have been adjusted for deflation into 2005 dollars using the GDP implicit price deflator. The quarterly values were averaged into a yearly value. Federal Reserve Bank of St. Louis Series DGS30, supra note 325 (accessed Nov. 3, 2010).

RealtyTrac Press Release on Foreclosure Activity, supra note 278.


Sales of new homes in May 2010 were 276,000, the lowest rate since 1963. It should be noted that this number likely reflects a shifting of sales from May to April prompted by the April expiration of tax credits designed to boost home sales. U.S. Census Bureau and U.S. Department of Housing and Urban Development, New Residential Sales in June 2010 (July 26, 2010) (online at www.census.gov/const/newressales.pdf); U.S. Census Bureau, New Residential Sales—New One-Family Houses Sold (onili at www.census.gov/ftp/pub/const/sold_cust.xls) (accessed Nov. 3, 2010).

The most recent data available is for July 2010. See Standard and Poor’s, S&P/CASE-Shiller Home Price Indices (Instrument: Case-Shiller 20-City Composite Seasonally Adjusted, Frequency: Monthly) (online at www.standardandpoors.com/indices/sp-case-shiller-home-price-in-

3. Housing Indices

Foreclosure actions, which consist of default notices, scheduled auctions, and bank repossessions, increased 2.5 percent in September to 347,420. This metric is over 24 percent above the foreclosure action level at the time of the EESA enactment. While the hardest hit states still account for 19 out of 20 of the highest metro foreclosure rates, foreclosure activity grew less in the hardest-hit cities than in other states. Sales of new homes increased to 307,000, but remain low. The Case-Shiller Composite 20-City Composite decreased very slightly, while the FHFA Housing Price Index increased very slightly in August 2010. The Case-Shiller and FHFA indices are 6 percent and 5 percent, respectively, below their levels of October 2008.
Additionally, Case-Shiller futures prices indicate a market expectation that home-price values for the major Metropolitan Statistical Areas (MSAs) will hold constant through 2011. These futures are cash-settled to a weighted composite index of U.S. housing prices in the top ten MSAs, as well as to those specific markets. They are used to hedge by businesses whose profits and losses are related to any area of the housing industry, and to balance portfolios by businesses seeking exposure to an uncorrelated asset class. As such, futures prices are a composite indicator of market information known to date and can be used to indicate market expectations for home prices.

FIGURE 23: HOUSING INDICATORS

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Most Recent Monthly Data</th>
<th>Percent Change from Data Available at Time of Last Report</th>
<th>Percent Change Since October 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly foreclosure actions</td>
<td>347,420</td>
<td>2.5</td>
<td>24.3</td>
</tr>
<tr>
<td>S&amp;P/Case-Shiller Composite 20 Index</td>
<td>146.99</td>
<td>(0.3)</td>
<td>(5.9)</td>
</tr>
<tr>
<td>FHFA Housing Price Index</td>
<td>192.83</td>
<td>0.4</td>
<td>(4.5)</td>
</tr>
</tbody>
</table>

333 A Metropolitan Statistical Area is defined as a core area containing a substantial population nucleus, together with adjacent communities having a high degree of economic and social integration with the core. U.S. Census Bureau, About Metropolitan and Micropolitan Statistical Areas (online at www.census.gov/population/www/metroareas/aboutmetro.html) (accessed Nov. 3, 2010).

334 Data accessed through Bloomberg data service on November 3, 2010. The Case-Shiller Futures contract is traded on the CME and is settled to the Case-Shiller Index two months after the previous calendar quarter. For example, the February contract will be settled against the spot value of the S&P Case-Shiller Home Price Index values representing the fourth calendar quarter of the previous year, which is released in February one day after the settlement of the contract. Note that most close observers believe that the accuracy of these futures contracts as forecasts diminishes the farther out one looks.
F. Financial Update

Each month, the Panel summarizes the resources that the federal government has committed to the rescue and recovery of the financial system. The following financial update provides: (1) An updated accounting of the TARP, including a tally of dividend income, repayments, and warrant dispositions that the program has received as of September 30, 2010; and (2) an updated accounting of the full federal resource commitment as of October 27, 2010.

1. The TARP
   a. Program Updates

Treasury’s spending authority under the TARP officially expired on October 3, 2010. Though it can no longer make new funding commitments, Treasury can continue to provide funding for programs for which it has existing contracts and previous commitments. To date, $395.1 billion has been spent under the TARP’s $475 billion ceiling. Of the total amount disbursed, $209.5 billion has been repaid. Treasury has also incurred $6.1 billion in

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338 All data normalized to 100 at January 2000. Futures data accessed through Bloomberg data service on November 3, 2010. S&P/Case-Shiller Home Price Indices, supra note 332


losses associated with its CPP and Automotive Industry Financing Program (AIFP) investments. A significant portion of the $179.7 billion in TARP funds currently outstanding includes Treasury’s investments in AIG and assistance provided to the automotive industry.

CPP Repayments

As of October 29, 2010, 112 of the 707 banks that participated in the CPP have fully redeemed their preferred shares either through capital repayment or exchanges for investments under the Community Development Capital Initiative (CDCI). During the month of October, Treasury received a $12 million full repayment from 1st Constitution Bancorp, and a $100 million partial repayment from Webster Financial Corporation. A total of $152.9 billion has been repaid under the program, leaving $49.5 billion in funds currently outstanding.

b. Income: Dividends, Interest, and Warrant Sales

In conjunction with its preferred stock investments under the CPP and TIP, Treasury generally received warrants to purchase common equity.\(^{341}\) As of October 29, 2010, 45 institutions have repurchased their warrants from Treasury at an agreed upon price. Treasury has also sold warrants for 15 other institutions at auction. To date, income from warrant dispositions have totaled $8.1 billion.

In addition to warrant proceeds, Treasury also receives dividend payments on the preferred shares that it holds under the CPP, 5 percent per annum for the first five years and 9 percent per annum thereafter.\(^{342}\) For preferred shares issued under the TIP, Treasury received a dividend of 8 percent per annum.\(^{343}\) In total, Treasury has received approximately $25.7 billion in net income from warrant repurchases, dividends, interest payments, and other proceeds deriving from TARP investments (after deducting losses).\(^{344}\) For further information on TARP profit and loss, see Figure 26.

\(^{341}\) For its CPP investments in privately held financial institutions, Treasury also received warrants to purchase additional shares of preferred stock, which it exercised immediately. Similarly, Treasury also received warrants to purchase additional subordinated debt that were also immediately exercised along with its CPP investments in subchapter S corporations. Treasury Transactions Report, \textit{supra} note 339, at 14.


c. TARP Accounting

FIGURE 25: TARP ACCOUNTING (AS OF OCTOBER 29, 2010)

([Dollars in billions])

<table>
<thead>
<tr>
<th>Program</th>
<th>Maximum Amount Allocated</th>
<th>Actual Funding</th>
<th>Total Repayments/ Reduced Exposure</th>
<th>Total Losses</th>
<th>Funding Currently Outstanding</th>
<th>Funding Available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Purchase Program (CPP)</td>
<td>$204.9</td>
<td>$204.9</td>
<td>$(152.9)</td>
<td>$(2.6)</td>
<td>$49.5</td>
<td>$0</td>
</tr>
<tr>
<td>Targeted Investment Program (TIP)</td>
<td>40.0</td>
<td>40.0</td>
<td>(40.0)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Asset Guarantee Program (AGP)</td>
<td>5.0</td>
<td>~5.0</td>
<td>(5.0)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>AIG Investment Program (AIGP)</td>
<td>69.8</td>
<td>~47.5</td>
<td>0</td>
<td>47.5</td>
<td>22.3</td>
<td>0</td>
</tr>
<tr>
<td>Auto Industry Financing Program (AIFP)</td>
<td>81.3</td>
<td>81.3</td>
<td>(10.8)</td>
<td>(3.5)</td>
<td>67.1</td>
<td>0</td>
</tr>
<tr>
<td>Auto Supplier Support Program (ASSP)</td>
<td>0.4</td>
<td>0.4</td>
<td>(0.4)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Term Asset-Backed Securities Loan Facility (TALF)</td>
<td>~4.3</td>
<td>~0.1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Public-Private Investment Program (PPIP)</td>
<td>22.4</td>
<td>~14.2</td>
<td>~0.4</td>
<td>13.8</td>
<td>8.2</td>
<td>0</td>
</tr>
<tr>
<td>SBA 7(a) Securities Purchase</td>
<td>0.4</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Home Affordable Modification Program (HAMP)</td>
<td>29.9</td>
<td>0.6</td>
<td>0</td>
<td>0</td>
<td>0.6</td>
<td>29.3</td>
</tr>
<tr>
<td>Hardest Hit Fund (HHF)</td>
<td>~4.0</td>
<td>~0.1</td>
<td>0</td>
<td>0</td>
<td>0.1</td>
<td>7.5</td>
</tr>
<tr>
<td>FHA Refinance Program</td>
<td>8.1</td>
<td>~0.1</td>
<td>0</td>
<td>0</td>
<td>0.1</td>
<td>8.0</td>
</tr>
<tr>
<td>Community Development</td>
<td>0.8</td>
<td>~0.6</td>
<td>0</td>
<td>0</td>
<td>0.6</td>
<td>0</td>
</tr>
<tr>
<td>Capital Initiative (CCDI)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$475.0</td>
<td>$395.1</td>
<td>$(299.5)</td>
<td>$(6.1)</td>
<td>$179.7</td>
<td>$79.5</td>
</tr>
</tbody>
</table>

*Figures affected by rounding. Unless otherwise noted, data in this table are from the following source: U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20Transactions%20Report%20as%20of%2010-29-10.pdf).

[Total amount repaid under CPP includes $13.4 billion Treasury received as part of its sales of Citigroup common stock. As of October 29, 2010, Treasury had sold 4.3 billion Citigroup common shares for $10.4 billion in gross proceeds. Treasury has received $3 billion in net profit from the sale of Citigroup common stock. In June 2009, Treasury exchanged $25 billion in Citigroup preferred stock for 7.7 billion shares of the company’s common stock at $3.25 per share. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010 at 13–15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20Report%20as%20of%2010-29-10.pdf).

[Treasury did receive other income as consideration for the guarantee, which is not a repayment and is accounted for in Figure 25.]

[The $5 billion AGP guarantee for Citigroup was unused since Treasury was not required to make any guarantee payments during the life of the program. U.S. Department of the Treasury, Troubled Asset Relief Program: Two-Year Retrospective at 25 (Oct. 2010) (online at www.financialstability.gov/docs/TARP%20Two%20Year%20Retrospective%2010%2005%2010%20transmittal%20letter.pdf).

[Although this $5 billion is no longer exposed as part of the AGP, Treasury did receive a repayment in the same sense as with other investments. Treasury did receive other income as consideration for the guarantee, which is not a repayment and is accounted for in Figure 25.]

[Allotted Maximum Exposure Reduced]

Also, following the bankruptcy proceedings for Old Chrysler, which extinguished the $1.9 billion debtor-in-possession (DIP) loan provided to Old Chrysler, Treasury retained the right to recover the proceeds from the liquidation of specified collateral. As of date, Treasury has collected $47.0 million in proceeds from the sale of collateral, and it does not expect a significant recovery from the liquidation proceeds. Treasury includes these proceeds as part of the $15.8 billion repaid under the AIFP. U.S. Department of the Treasury, Troubled Asset Relief Program Monthly 105(a) Report—September 2010 (Oct. 12, 2010) (online at financialstability.gov/docs/105CongressionalReports/September 105(a) report-FINAL.pdf).

On the TARP Transactions Report, the $1.9 billion Chrysler debtor-in-possession loan, which was extinguished April 30, 2010, was deducted from Treasury’s AIFP investment amount. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 10 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10TransactionsReportasof10-29-10.pdf).

Of the TARP program, one dollar of TARP funds was committed for every $10 of funds obligated by the Federal Reserve. The program was intended to be a $200 billion initiative, and the TARP was responsible for the first $20 billion in loan-losses, if any were incurred. The loan was implemented incrementally. When the program started in June 2008, a total of $43 billion in loans was outstanding under the TARP program, and the TARP’s commitments constituted $4.3 billion. The Federal Reserve Board of Governors agreed that it was appropriate for Treasury to reduce TALF credit protection from TARP to $4.3 billion. Board of Governors of the Federal Reserve System, Federal Reserve Announcement Agreement With the Treasury Department Regarding a Reduction of Credit Protection Provided for the Term Asset-Backed Securities Loan Facility (TALF) (July 20, 2010) (online at www.federalreserve.gov/newsevents/press/monetary/20100720a.html).

As of October 27, 2010, Treasury had provided $1.05 billion to TALF LLC. This total includes accrued payable interest. Federal Reserve Bank of New York, Factors Affecting Reserve Balances (H.4.1) (Oct. 20, 2010) (online at www.federalreserve.gov/releases/h41/20101028/).

As of October 27, 2010, Treasury allocated an additional $2 billion in proceeds from the sale of collateral, and it does not expect a significant recovery from the liquidation proceeds. Treasury includes these proceeds as part of the $15.8 billion repaid under the AIFP. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 22 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10TransactionsReportasof10-29-10.pdf).


As of November 10, 2010, a total of $63.6 million has been disbursed to seven state Housing Finance Agencies (HFAs). Data provided by Treasury staff (Nov. 10, 2010).

This figure represents the amount Treasury disbursed to fund the advance purchase account of the letter of credit issued under the FHA Home Equity Conversion Mortgage (HECM) program. Data provided by Treasury staff (Nov. 10, 2010).


This figure represents the amount Treasury disbursed to fund the advance purchase account of the letter of credit issued under the FHA Home Equity Conversion Mortgage (HECM) program. Data provided by Treasury staff (Nov. 10, 2010).
The U.S. Treasury has sold its preferred ownership interests and warrants from So uth Financial Group, CIT Group ($2.1 billion) and Pacific Coast National Bancorp ($4.1 million), as losses. Treasury has also sold its preferred ownership interests and warrants from South Financial Group, Inc. and TIB Financial Corp. This represents a $241.3 million loss on its CPP investments in these two banks. Two TARP recipients, UCBH Holdings, Inc. ($288.7 million) and a banking subsidiary of Midwest Banc Holdings, Inc. ($384.4 million), are currently in bankruptcy proceedings.

In 2009, Treasury received the $307.5 million termination fee from Citigroup for its second-loss guaranty. It never reached an agreement with Citigroup for the recapitalization of Citigroup. Treasury received the $276 million aggregate termination fee from Bank of America and $57 million from AIG. In the TARP Transactions Report, Treasury classified the investments it made in two institutions, CIT Group ($2.3 billion) and Pacific Coast National Bancorp ($4.1 million), as losses. Treasury has also sold its preferred ownership interests and warrants from South Financial Group, Inc. and TIB Financial Corp. This represents a $241.3 million loss on its CPP investments in these two banks. Two TARP recipients, UCBH Holdings, Inc. ($288.7 million) and a banking subsidiary of Midwest Banc Holdings, Inc. ($384.4 million), are currently in bankruptcy proceedings.

TABLE 26: TARP PROFIT AND LOSS

[Dollars in millions]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CPP</td>
<td>9,859</td>
<td>49</td>
<td>6,904</td>
<td>3,015</td>
<td>22,570</td>
</tr>
<tr>
<td>TIP</td>
<td>3,004</td>
<td>6,256</td>
<td></td>
<td></td>
<td>9,260</td>
</tr>
<tr>
<td>AIFP</td>
<td>3,418</td>
<td>931</td>
<td>15</td>
<td>15</td>
<td>4,487</td>
</tr>
<tr>
<td>ASSP</td>
<td>440</td>
<td>56</td>
<td></td>
<td></td>
<td>501</td>
</tr>
<tr>
<td>AGP</td>
<td>101</td>
<td>15</td>
<td></td>
<td></td>
<td>116</td>
</tr>
<tr>
<td>PPI</td>
<td>1,016</td>
<td>15</td>
<td></td>
<td></td>
<td>1,031</td>
</tr>
<tr>
<td>SBA 7(a)</td>
<td>2,246</td>
<td>2,686</td>
<td></td>
<td></td>
<td>5,932</td>
</tr>
<tr>
<td>Bank of America</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>12,630</td>
</tr>
<tr>
<td>Total</td>
<td>$16,721</td>
<td>$8,160</td>
<td>$5,833</td>
<td>($6,034)</td>
<td>$25,732</td>
</tr>
</tbody>
</table>

xxviii This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxix As of September 30, 2010, Treasury has earned $159.1 million in membership interest distributions from the PPIP. Additionally, Treasury has earned $20.6 million in total proceeds following the termination of the TCW fund. See U.S. Department of the Treasury, Cumulative Dividends, Interest and Distributions Report as of September 30, 2010, at 14 (Oct. 12, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxx This figure includes $815 million in dividends from GMAC preferred stock, trust preferred securities, and mandatorily convertible preferred shares. The dividend total also includes a $148.6 million senior unsecured note from Treasury’s investment in General Motors. Data provided by Treasury.

xxxii This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxiii This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxiv This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxv This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxvi This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxvii This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).

xxxviii This figure represents net proceeds to Treasury from the sale of Citigroup common stock to date. For details on Treasury’s sales of Citigroup common stock, see note ii, supra. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 15 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20transactions%20report%20as%20of%2010-29-10.pdf).
d. CPP Unpaid Dividend and Interest Payments

As of September 30, 2010, 120 institutions have at least one dividend payment on preferred stock issued under CPP outstanding. Among these institutions, 95 are not current on cumulative dividends, amounting to $114.8 million in missed payments. Another 25 banks have not paid $8 million in non-cumulative dividends. Of the $49.5 billion currently outstanding in CPP funding, Treasury's investments in banks with non-current dividend payments total $3.5 billion. A majority of the banks that remain delinquent on dividend payments have under $1 billion in total assets on their balance sheets. Also, there are 21 institutions that no longer have outstanding unpaid dividends, after previously deferring their quarterly payments.

Six banks have failed to make six dividend payments, while one bank has missed all seven quarterly payments. These institutions have received a total of $207.1 million in CPP funding. Under the terms of the CPP, after a bank fails to pay dividends for six periods, Treasury has the right to elect two individuals to the company's board of directors. Figure 27 below provides further details on the distribution and the number of institutions that have missed dividend payments.

In addition, eight CPP participants have missed at least one interest payment, representing $3.6 million in cumulative unpaid interest payments. Treasury's total investments in these non-public institutions represent less than $1 billion in CPP funding.

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346 Does not include banks with missed dividend payments that have either repaid all delinquent dividends, exited TARP, gone into receivership, or filed for bankruptcy.
347 Includes institutions that have either (a) fully repaid their CPP investment and exited the program or (b) entered bankruptcy or its subsidiary was placed into receivership. Treasury Cumulative Dividends, Interest and Distributions Report, supra note 339, at 20.
Calculation of the internal rate of return (IRR) also includes CPP investments in public institutions not repaid in full (for reasons such as acquisition by another institution) in the Transaction Report, e.g., The South Financial Group and TIB Financial Corporation. The Panel’s total IRR calculation now includes CPP investments in public institutions recorded as a loss on the TARP Transaction Report due to bankruptcy, e.g., CIT Group Inc. Going forward, the Panel will continue to include losses due to bankruptcy when Treasury determines any associated contingent value rights have expired without value. When excluding CIT Group from the calculation, the resulting IRR is 10.4 percent. Treasury Transactions Report, supra note 339.

FIGURE 27: CPP MISSED DIVIDEND PAYMENTS (AS OF SEPTEMBER 30, 2010) 349

<table>
<thead>
<tr>
<th>Number of Missed Payments</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative Dividends</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Banks, by asset size</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under $1B</td>
<td>29</td>
<td>19</td>
<td>17</td>
<td>17</td>
<td>10</td>
<td>3</td>
<td>0</td>
<td>95</td>
</tr>
<tr>
<td>$1B–$10B</td>
<td>20</td>
<td>15</td>
<td>12</td>
<td>11</td>
<td>5</td>
<td>1</td>
<td>0</td>
<td>64</td>
</tr>
<tr>
<td>Over $10B</td>
<td>8</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>5</td>
<td>2</td>
<td>0</td>
<td>29</td>
</tr>
<tr>
<td>Non-Cumulative Dividends</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Banks, by asset size</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under $1B</td>
<td>2</td>
<td>5</td>
<td>6</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>25</td>
</tr>
<tr>
<td>$1B–$10B</td>
<td>1</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>23</td>
</tr>
<tr>
<td>Over $10B</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Missed Payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>120</td>
</tr>
</tbody>
</table>


e. Rate of Return

As of November 4, 2010, the average internal rate of return for all public financial institutions that participated in the CPP and fully repaid the U.S. government (including preferred shares, dividends, and warrants) remained at 8.4 percent, as no institutions exited the program in October.350 The internal rate of return is the annualized effective compounded return rate that can be earned on invested capital.

350 Calculation of the internal rate of return (IRR) also includes CPP investments in public institutions not repaid in full (for reasons such as acquisition by another institution) in the Transaction Report, e.g., The South Financial Group and TIB Financial Corporation. The Panel’s total IRR calculation now includes CPP investments in public institutions recorded as a loss on the TARP Transaction Report due to bankruptcy, e.g., CIT Group Inc. Going forward, the Panel will continue to include losses due to bankruptcy when Treasury determines any associated contingent value rights have expired without value. When excluding CIT Group from the calculation, the resulting IRR is 10.4 percent. Treasury Transactions Report, supra note 339.
### f. Warrant Disposition

**FIGURE 28: WARRANT REPURCHASES/AUCTIONS FOR FINANCIAL INSTITUTIONS WHO HAVE FULLY REPAID CPP FUNDS (AS OF NOVEMBER 4, 2010)**

<table>
<thead>
<tr>
<th>Institution</th>
<th>Investment Date</th>
<th>Warrant Repurchase Date</th>
<th>Warrant Repurchase/Sale Amount</th>
<th>Panel’s Best Valuation Estimate at Disposition Date</th>
<th>Price/Estimate Ratio</th>
<th>IRR (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old National Bancorp</td>
<td>12/12/2008</td>
<td>5/8/2009</td>
<td>$1,200,000</td>
<td>$2,150,000</td>
<td>0.558</td>
<td>9.3</td>
</tr>
<tr>
<td>Iberiabank Corporation</td>
<td>12/5/2008</td>
<td>5/20/2009</td>
<td>1,200,000</td>
<td>2,010,000</td>
<td>0.597</td>
<td>9.4</td>
</tr>
<tr>
<td>Fiserve Corporation</td>
<td>12/31/2008</td>
<td>5/27/2009</td>
<td>5,025,000</td>
<td>4,260,000</td>
<td>1.180</td>
<td>20.3</td>
</tr>
<tr>
<td>Sun Bancorp, Inc</td>
<td>1/9/2009</td>
<td>5/27/2009</td>
<td>2,100,000</td>
<td>5,580,000</td>
<td>0.376</td>
<td>15.3</td>
</tr>
<tr>
<td>Independent Bank Corp.</td>
<td>1/9/2009</td>
<td>5/27/2009</td>
<td>2,200,000</td>
<td>3,870,000</td>
<td>0.568</td>
<td>15.6</td>
</tr>
<tr>
<td>Alliance Financial Corporation</td>
<td>12/19/2008</td>
<td>6/17/2009</td>
<td>900,000</td>
<td>1,580,000</td>
<td>0.570</td>
<td>13.8</td>
</tr>
<tr>
<td>First Niagara Financial Group</td>
<td>11/21/2008</td>
<td>6/24/2009</td>
<td>2,700,000</td>
<td>3,050,000</td>
<td>0.885</td>
<td>8.0</td>
</tr>
<tr>
<td>Berkshire Hills Bancorp, Inc.</td>
<td>12/19/2008</td>
<td>6/24/2009</td>
<td>1,040,000</td>
<td>1,620,000</td>
<td>0.642</td>
<td>11.3</td>
</tr>
<tr>
<td>Somerset Hills Bancorp</td>
<td>1/18/2009</td>
<td>6/24/2009</td>
<td>275,000</td>
<td>580,000</td>
<td>0.474</td>
<td>16.6</td>
</tr>
<tr>
<td>SCBT Financial Corporation</td>
<td>1/18/2009</td>
<td>6/24/2009</td>
<td>1,400,000</td>
<td>2,290,000</td>
<td>0.611</td>
<td>11.7</td>
</tr>
<tr>
<td>HF Financial Corp.</td>
<td>11/21/2008</td>
<td>6/20/2009</td>
<td>650,000</td>
<td>1,240,000</td>
<td>0.524</td>
<td>10.1</td>
</tr>
<tr>
<td>State Street</td>
<td>10/28/2008</td>
<td>7/8/2009</td>
<td>60,000,000</td>
<td>54,200,000</td>
<td>1.077</td>
<td>9.9</td>
</tr>
<tr>
<td>U.S. Bancorp</td>
<td>11/14/2008</td>
<td>7/15/2009</td>
<td>139,000,000</td>
<td>135,100,000</td>
<td>1.029</td>
<td>8.7</td>
</tr>
<tr>
<td>The Goldman Sachs Group, Inc</td>
<td>10/28/2008</td>
<td>7/22/2009</td>
<td>1,100,000,000</td>
<td>1,128,400,000</td>
<td>0.975</td>
<td>22.8</td>
</tr>
<tr>
<td>BB&amp;T Corp.</td>
<td>11/14/2008</td>
<td>7/22/2009</td>
<td>67,010,402</td>
<td>68,200,000</td>
<td>0.983</td>
<td>8.7</td>
</tr>
<tr>
<td>American Express Company</td>
<td>1/9/2009</td>
<td>7/21/2009</td>
<td>340,000,000</td>
<td>391,200,000</td>
<td>0.869</td>
<td>29.5</td>
</tr>
<tr>
<td>Bank of New York Mellon Corp</td>
<td>10/28/2008</td>
<td>8/9/2009</td>
<td>136,000,000</td>
<td>155,700,000</td>
<td>0.873</td>
<td>12.3</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>10/28/2008</td>
<td>8/12/2009</td>
<td>950,000,000</td>
<td>1,039,800,000</td>
<td>0.914</td>
<td>20.2</td>
</tr>
<tr>
<td>Northern Trust Corporation</td>
<td>11/14/2008</td>
<td>8/26/2009</td>
<td>87,000,000</td>
<td>89,800,000</td>
<td>0.969</td>
<td>14.5</td>
</tr>
<tr>
<td>Old Line Bancshares Inc.</td>
<td>12/5/2008</td>
<td>9/2/2009</td>
<td>225,000</td>
<td>500,000</td>
<td>0.450</td>
<td>10.4</td>
</tr>
<tr>
<td>Bancorp Rhode Island, Inc.</td>
<td>12/19/2008</td>
<td>9/30/2009</td>
<td>1,400,000</td>
<td>1,400,000</td>
<td>1.000</td>
<td>12.6</td>
</tr>
<tr>
<td>Centerstate Banks of Florida Inc.</td>
<td>11/21/2008</td>
<td>10/29/2009</td>
<td>212,000</td>
<td>220,000</td>
<td>0.964</td>
<td>5.9</td>
</tr>
<tr>
<td>Manhattan Bancorp</td>
<td>12/5/2008</td>
<td>10/14/2009</td>
<td>63,364</td>
<td>140,000</td>
<td>0.453</td>
<td>9.8</td>
</tr>
<tr>
<td>CVB Financial Corp</td>
<td>12/5/2008</td>
<td>10/28/2009</td>
<td>1,307,000</td>
<td>3,522,198</td>
<td>0.371</td>
<td>6.4</td>
</tr>
<tr>
<td>Bank of the Ozarks</td>
<td>12/12/2008</td>
<td>11/24/2009</td>
<td>2,650,000</td>
<td>2,500,000</td>
<td>0.757</td>
<td>9.0</td>
</tr>
<tr>
<td>Capital One Financial</td>
<td>11/14/2008</td>
<td>12/3/2009</td>
<td>148,713,030</td>
<td>232,000,000</td>
<td>0.641</td>
<td>12.0</td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co.</td>
<td>10/28/2008</td>
<td>12/10/2009</td>
<td>950,318,243</td>
<td>1,006,587,697</td>
<td>0.944</td>
<td>10.9</td>
</tr>
<tr>
<td>CIT Group Inc.</td>
<td>12/31/2008</td>
<td>–</td>
<td>562,341</td>
<td>(97.2)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TCF Financial Corp.</td>
<td>1/18/2009</td>
<td>12/16/2009</td>
<td>9,599,964</td>
<td>11,825,830</td>
<td>0.812</td>
<td>11.0</td>
</tr>
<tr>
<td>LSB Corporation</td>
<td>12/12/2008</td>
<td>12/16/2009</td>
<td>560,000</td>
<td>535,202</td>
<td>1.046</td>
<td>9.0</td>
</tr>
<tr>
<td>Wainwright Bank &amp; Trust Company</td>
<td>12/19/2008</td>
<td>12/16/2009</td>
<td>568,700</td>
<td>1,071,494</td>
<td>0.531</td>
<td>7.8</td>
</tr>
<tr>
<td>Wesbanco Bank, Inc.</td>
<td>12/5/2008</td>
<td>12/23/2009</td>
<td>950,000</td>
<td>2,387,617</td>
<td>0.398</td>
<td>6.7</td>
</tr>
<tr>
<td>Union First Market Bancshares Corporation (Union Bancshares Corporation)</td>
<td>12/19/2008</td>
<td>12/31/2009</td>
<td>450,000</td>
<td>1,130,418</td>
<td>0.398</td>
<td>5.8</td>
</tr>
<tr>
<td>Trustmark Corporation</td>
<td>11/21/2008</td>
<td>12/30/2009</td>
<td>10,000,000</td>
<td>11,573,699</td>
<td>0.864</td>
<td>9.4</td>
</tr>
<tr>
<td>Flushing Financial Corporation</td>
<td>12/19/2008</td>
<td>12/30/2009</td>
<td>900,000</td>
<td>2,861,919</td>
<td>0.314</td>
<td>6.5</td>
</tr>
<tr>
<td>Monarch Financial Holdings, Inc.</td>
<td>12/19/2008</td>
<td>2/18/2010</td>
<td>260,000</td>
<td>623,434</td>
<td>0.417</td>
<td>6.7</td>
</tr>
</tbody>
</table>

**Notes:**
- IRR (Percent) calculated as in-removal rate of 89.
- Investment Date refers to the date the investment was made.
- Warrant Repurchase Date indicates when the warrant was repurchased.
- Warrant Repurchase/Sale Amount represents the amount repurchased or sold.
- Panel’s Best Valuation Estimate at Disposition Date provides the estimate for the warrant valuation at the time of disposition.
- Price/Estimate Ratio indicates the ratio of the repurchase or sale price to the estimated valuation.
- IRR (Percent) reflects the internal rate of return calculated on the warrant investment.
### FIGURE 28: WARRANT REPURCHASES/AUCTIONS FOR FINANCIAL INSTITUTIONS WHO HAVE FULLY REPAID CPP FUNDS (AS OF NOVEMBER 4, 2010)—Continued

<table>
<thead>
<tr>
<th>Institution</th>
<th>Investment Date</th>
<th>Warrant Repurchase Date</th>
<th>Warrant Repurchase/Sale Amount</th>
<th>Panel’s Best Valuation Estimate at Disposition Date</th>
<th>Price/Estimate Ratio</th>
<th>IRR (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SVB Financial Group</td>
<td>12/12/2008</td>
<td>6/16/2010</td>
<td>6,820,000</td>
<td>7,884,633</td>
<td>0.865</td>
<td>7.7</td>
</tr>
<tr>
<td>Discover Financial Services</td>
<td>3/13/2009</td>
<td>7/7/2010</td>
<td>172,000,000</td>
<td>166,182,652</td>
<td>1.035</td>
<td>17.1</td>
</tr>
<tr>
<td>Bar Harbor Bancshares</td>
<td>1/16/2009</td>
<td>7/28/2010</td>
<td>250,000</td>
<td>518,511</td>
<td>0.482</td>
<td>6.2</td>
</tr>
<tr>
<td>Citizens &amp; Northern Corporation</td>
<td>1/16/2009</td>
<td>8/4/2010</td>
<td>400,000</td>
<td>468,164</td>
<td>0.854</td>
<td>5.9</td>
</tr>
<tr>
<td>Hartford Financial Services Group, Inc.</td>
<td>6/26/2009</td>
<td>9/21/2010</td>
<td>713,687,430</td>
<td>472,221,996</td>
<td>1.511</td>
<td>30.3</td>
</tr>
<tr>
<td>Lincoln National Corporation</td>
<td>7/10/2009</td>
<td>9/16/2010</td>
<td>216,620,887</td>
<td>181,431,183</td>
<td>1.194</td>
<td>27.1</td>
</tr>
<tr>
<td>The Bancorp, Inc./The Bancorp Bank</td>
<td>12/12/2008</td>
<td>9/8/2010</td>
<td>4,753,985</td>
<td>9,947,683</td>
<td>0.478</td>
<td>12.8</td>
</tr>
<tr>
<td>South Financial Group, Inc./Carolina First Bank</td>
<td>12/5/2008</td>
<td>9/30/2010</td>
<td>40,000</td>
<td>235,757</td>
<td>0.170</td>
<td>(38.0)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>$8,148,332,166</td>
<td>$7,999,843,254</td>
<td>1.019</td>
<td>8.4</td>
</tr>
</tbody>
</table>

351 Investment date for Bank of America in CPP.
352 Investment date for Merrill Lynch in CPP.
353 Investment date for Bank of America in TIP.

### FIGURE 29: VALUATION OF CURRENT HOLDINGS OF WARRANTS (AS OF NOVEMBER 4, 2010)

<table>
<thead>
<tr>
<th>Financial Institutions with Warrants Outstanding</th>
<th>Warrant Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low Estimate</td>
</tr>
<tr>
<td>Citigroup, Inc.354</td>
<td>$71.57</td>
</tr>
<tr>
<td>SunTrust Banks, Inc.</td>
<td>17.34</td>
</tr>
<tr>
<td>Regions Financial Corporation</td>
<td>5.94</td>
</tr>
<tr>
<td>Fifth Third Bancorp</td>
<td>96.96</td>
</tr>
<tr>
<td>KeyCorp</td>
<td>20.90</td>
</tr>
<tr>
<td>AIG</td>
<td>419.89</td>
</tr>
<tr>
<td>All Other Banks</td>
<td>379.97</td>
</tr>
<tr>
<td>Total</td>
<td>$1,012.57</td>
</tr>
</tbody>
</table>

354 Includes warrants issued under CPP, AGP, and TIP.

### 2. Federal Financial Stability Efforts

#### a. Federal Reserve and FDIC Programs

In addition to the direct expenditures Treasury has undertaken through the TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its Section 13(3) facilities and special purpose vehicles (SPVs) and the FDIC's Temporary Liquidity Guarantee Program (TLGP), operate independently of the TARP.
b. Total Financial Stability Resources

Beginning in its April 2009 report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through myriad new programs and initiatives as outlays, loans, or guarantees. With the reductions in funding for certain TARP programs, the Panel calculates the total value of these resources to be over $2.5 trillion. However, this would translate into the ultimate “cost” of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off.

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. As discussed in the Panel’s November 2009 report, the FDIC assesses a premium of up to 100 basis points on TLGP debt guarantees.355 In contrast, the Federal Reserve’s liquidity programs are generally available only to borrowers with good credit, and the loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the “haircut,” the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower’s other assets to make the Federal Reserve whole. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy.

c. Credit Union Assistance

Apart from the assistance credit unions have received through the CDCI, the National Credit Union Administration (NCUA), the federal agency charged with regulating federal credit unions (FCUs), has also made efforts to stabilize the corporate credit union (CCU) system. Corporate credit unions provide correspondent services, as well as liquidation and investment services to retail (or consumer) credit unions.356 Since March 2009, the NCUA has placed five CCUs into conservatorship due to their exposure to underperforming private-label MBS. The NCUA estimates that these five institutions, which have $72 billion in assets and provide services for 4,600 retail credit unions, hold more than 90 percent of the MBS in the corporate credit union system.357

To assist in the NCUA’s stabilization efforts, the Temporary Corporate Credit Union Stabilization Fund (“Stabilization Fund”) was created to help cover costs associated with CCU conservatorships.

356 National Credit Union Administration, Corporate System Resolution: Corporate Credit Unions Frequently Asked Questions (FAQs), at 1 (online at www.ncua.gov/Resources/CorporateCU/CSR/CSR-6.pdf).
and liquidations. The Stabilization Fund was established on May 20, 2009, as part of the Helping Families Save Their Homes Act of 2009, and allows the NCUA to borrow up to $6 billion from Treasury on a revolving basis. The NCUA had drawn a total of $1.5 billion from the Stabilization Fund, and repaid the balance at the end of September.

d. Mortgage Purchase Programs

On September 7, 2008, Treasury announced the GSE Mortgage Backed Securities Purchase Program. The Housing and Economic Recovery Act of 2008 provided Treasury with the authority to purchase MBS guaranteed by GSEs through December 31, 2009. Treasury purchased approximately $225 billion in GSE MBS by the time its authority expired. As of October 2010, there was approximately $154.6 billion in MBS still outstanding under this program.

In March 2009, the Federal Reserve authorized purchases of $1.25 trillion MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae, and $200 billion of agency debt securities from Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The intended purchase amount for agency debt securities was subsequently decreased to $175 billion. All purchasing activity was completed on March 31, 2010. As of November 10, the Federal Reserve held $1.05 trillion of agency MBS and $150 billion of agency debt.

e. Federal Reserve Treasury Securities Purchases

On November 3, 2010, the Federal Open Market Committee (FOMC) announced that it has directed FRBNY to begin purchasing an additional $600 billion in longer-term Treasury securities. In addition, FRBNY will reinvest $250 billion to $350 billion in principal payments from agency debt and agency MBS in Treasury securities. The additional purchases and reinvestments will...

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361 U.S. Department of the Treasury, MBS Purchase Program: Portfolio by Month (online at www.financialstability.gov/docs/October%202010%20Portfolio%20by%20month.pdf) (accessed Nov. 12, 2010). Treasury has received $65.7 billion in principal repayments and $14.3 billion in interest payments from these securities. See U.S. Department of the Treasury, MBS Purchase Program Principal and Interest Received (online at www.financialstability.gov/doc/October%202010%20Principal%20and%20Interest%20Monthly%20Breakout.pdf) (accessed Nov. 12, 2010).
362 Federal Reserve Report on Credit and Liquidity Programs and the Balance Sheet, supra note 251, at 5.
363 Federal Reserve Report on Credit and Liquidity Programs and the Balance Sheet, supra note 251, at 5.
be conducted through the end of the second quarter 2011, meaning the pace of purchases will be approximately $110 billion per month. In order to facilitate these purchases, FRBNY will temporarily lift its System Open Market Account per-issue limit, which prohibits the Federal Reserve’s holdings of an individual security from surpassing 35 percent of the outstanding amount.\footnote{\textit{Federal Reserve Bank of New York, FAQs: Purchases of Longer-term Treasury Securities (Nov. 3, 2010) (online at www.newyorkfed.org/markets/lttreas_faq.html).}} As of November 10, 2010, the Federal Reserve held $853 billion in Treasury securities.\footnote{\textit{Federal Reserve Statistical Release H.4.1, supra note 251.}}

FIGURE 30: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF OCTOBER 27, 2010)\textsuperscript{xxxiii}

<table>
<thead>
<tr>
<th>Program</th>
<th>Treasury (TARP)</th>
<th>Federal Reserve</th>
<th>FDIC</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$475</td>
<td>$1,378.0</td>
<td>$690.9</td>
<td>$2,544.0</td>
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<tr>
<td>Outlays\textsuperscript{xxxx}</td>
<td>232.2</td>
<td>1,226.8</td>
<td>188.9</td>
<td>1,648.0</td>
</tr>
<tr>
<td>Loans</td>
<td>23.4</td>
<td>151.2</td>
<td>0</td>
<td>174.6</td>
</tr>
<tr>
<td>Guarantees\textsuperscript{xxxx}</td>
<td>4.3</td>
<td>0</td>
<td>502</td>
<td>506.3</td>
</tr>
<tr>
<td>Repaid and Unavailable TARP Funds</td>
<td>215.1</td>
<td>0</td>
<td>0</td>
<td>215.1</td>
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<tr>
<td>AIG\textsuperscript{xxxx}</td>
<td>69.8</td>
<td>83.1</td>
<td>0</td>
<td>152.9</td>
</tr>
<tr>
<td>Outlays\textsuperscript{xxxx}</td>
<td>69.8</td>
<td>26.1</td>
<td>0</td>
<td>95.9</td>
</tr>
<tr>
<td>Loans\textsuperscript{xxxx}</td>
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<td>57.1</td>
<td>0</td>
<td>57.1</td>
</tr>
<tr>
<td>Guarantees\textsuperscript{xxxx}</td>
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<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Citigroup</td>
<td>11.6</td>
<td>0</td>
<td>0</td>
<td>11.6</td>
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<td>Outlays\textsuperscript{xl}</td>
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<td>0</td>
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<tr>
<td>Loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td>Guarantees\textsuperscript{xlii}</td>
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<td>0</td>
</tr>
<tr>
<td>Capital Purchase Program (Other)</td>
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</tr>
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<tr>
<td>Loans</td>
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<td>0</td>
<td>0</td>
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<td>0</td>
<td>0</td>
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</tr>
<tr>
<td>Capital Assistance Program</td>
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<td>0</td>
<td>N/A</td>
</tr>
<tr>
<td>TALF\textsuperscript{xliii}</td>
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<td>0</td>
<td>43.0</td>
</tr>
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<td>0</td>
</tr>
<tr>
<td>Loans\textsuperscript{xliii}</td>
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<tr>
<td>PPIP (Loans)\textsuperscript{xlv}</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Outlays\textsuperscript{xlv}</td>
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<td>0</td>
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<tr>
<td>Loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Guarantees\textsuperscript{xlv}</td>
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<td>0</td>
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<tr>
<td>PPIP (Securities)\textsuperscript{xlv}</td>
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<tr>
<td>Loans</td>
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<td>14.9</td>
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<tr>
<td>Outlays\textsuperscript{xlvii}</td>
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<tr>
<td>Loans</td>
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<td>0</td>
<td>0</td>
<td>0</td>
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<td>0</td>
</tr>
<tr>
<td>Automotive Industry Financing Program\textsuperscript{xlviii}</td>
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<td>0</td>
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<tr>
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<tr>
<td>Loans</td>
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<td>0</td>
<td>8.1</td>
</tr>
<tr>
<td>Guarantees\textsuperscript{xlviii}</td>
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<tr>
<td>Automotive Supplier Support Program</td>
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<td>0.4</td>
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<td>0</td>
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</tr>
<tr>
<td>Loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<td>SBA 7(a) Securities Purchase</td>
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<td>0.36</td>
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<tr>
<td>Outlays\textsuperscript{xl}</td>
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<td>0</td>
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<td>0.36</td>
</tr>
<tr>
<td>Loans</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

\textsuperscript{xxxiii} Figures in billions.

\textsuperscript{xxxx} Federal Reserve Statistical Release H.4.1, supra note 251.

### FIGURE 30: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF OCTOBER 27, 2010) xxxiii—Continued

(Dollars in billions)

<table>
<thead>
<tr>
<th>Program</th>
<th>Treasury (TARP)</th>
<th>Federal Reserve</th>
<th>FDIC</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community Development Capital Initiative</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Outlays</td>
<td>0.57</td>
<td>0</td>
<td>0</td>
<td>0.57</td>
</tr>
<tr>
<td>Loans</td>
<td>0.57</td>
<td>0</td>
<td>0</td>
<td>0.57</td>
</tr>
<tr>
<td>Guarantees</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Temporary Liquidity Guarantee Program</td>
<td>0</td>
<td>0</td>
<td>502.0</td>
<td>502.0</td>
</tr>
<tr>
<td>Outlays</td>
<td>0</td>
<td>0</td>
<td>188.9</td>
<td>188.9</td>
</tr>
<tr>
<td>Loans</td>
<td>0</td>
<td>0</td>
<td>188.9</td>
<td>188.9</td>
</tr>
<tr>
<td>Guarantees</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Deposit Insurance Fund</td>
<td>0</td>
<td>0</td>
<td>1,256.1</td>
<td>1,256.1</td>
</tr>
<tr>
<td>Outlays</td>
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<td>1,200.7</td>
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<td>1,200.7</td>
</tr>
<tr>
<td>Loans</td>
<td>0</td>
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<td>0</td>
<td>55.4</td>
</tr>
<tr>
<td>Guarantees</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

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*xxxiii* Unless otherwise noted, all data in this figure are as of October 27, 2010.

The term “outlays” is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). These values were calculated using (1) Treasury's actual reported expenditures, and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury statements and GAO estimates. Anticipated funding levels are set at Treasury’s discretion, have changed from initial announcements, and are subject to further change. Outlays used here represent investment and asset purchases—as well as commitments to make investments and asset purchases—and are not the same as budget outlays, which under section 123 of EESA are recorded on a “credit reform” basis.

Although many of the guaranties may never be exercised or will be exercised only partially, the guaranty figures included here represent the federal government’s greatest possible financial exposure.

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<table>
<thead>
<tr>
<th>Factors Affecting Reserve Balances (H.4.1)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Program</th>
<th>Outlays</th>
<th>Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treasury Announcement Regarding the Capital Assistance Program (Nov. 9, 2009)</td>
<td>0.57</td>
<td>0.57</td>
</tr>
<tr>
<td>U.S. Department of the Treasury, Treasury Update on AIG Investment Valuation (Nov. 1, 2010)</td>
<td>0.57</td>
<td>0.57</td>
</tr>
<tr>
<td>Temporary Liquidity Guarantee Program (Nov. 1, 2010)</td>
<td>0.57</td>
<td>0.57</td>
</tr>
<tr>
<td>Deposit Insurance Fund (Nov. 1, 2010)</td>
<td>0.57</td>
<td>0.57</td>
</tr>
</tbody>
</table>

---

*xxxiv* The maximum amount available through the RCF decreased from $34.4 billion to $29.3 billion between March and September 2010, as a result of the sale of two AIG subsidiaries, as well as the company’s sale of CME Group Inc. common stock. The reduced ceiling also reflects a $13.95 billion repayment to the RCF from proceeds earned from a debt offering by the International Lease Finance Corporation (ILFC), an AIG subsidiary. Board of Governors of the Federal Reserve System, Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet, at 18 (Oct. 2010) (online at www.federalreserve.gov/releases/h41/20101028/).

*xxxv* This number represents the full $29.3 billion made available to AIG through its Revolving Credit Facility (RCF) with FRBNY ($18.9 billion had been drawn down as of October 27, 2010) and the outstanding principal of the loans extended to the Maiden Lane II and III SPVs to AIG through the RCF. The outstanding principal of $10.4 billion is the full amount currently due and owing on the $29.3 billion RCF credit line.

*xxxvi* This number includes investments under the AMERIPRISE Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment made on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). The amount repaid comes from the $16.4 billion in gross proceeds Treasury received from the sale of 4.1 billion Citigroup common shares.

*xxxvii* This number includes investments under the AIGIP/SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment made on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). The amount repaid comes from the $16.4 billion in gross proceeds Treasury received from the sale of 4.1 billion Citigroup common shares.

*xxxviii* The maximum amount available through the RCF decreased from $34.4 billion to $29.3 billion between March and September 2010, as a result of the sale of two AIG subsidiaries, as well as the company’s sale of CME Group Inc. common stock. The reduced ceiling also reflects a $13.95 billion repayment to the RCF from proceeds earned from a debt offering by the International Lease Finance Corporation (ILFC), an AIG subsidiary. Board of Governors of the Federal Reserve System, Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet, at 18 (Oct. 2010) (online at www.federalreserve.gov/releases/h41/20101028/).

*xxxix* This figure represents Treasury’s $25 billion investment in Citigroup, minus $13.4 billion applied as a repayment for CPP funding. The amount repaid comes from the $16.4 billion in gross proceeds Treasury received from the sale of 4.1 billion Citigroup common shares. See note ii, supra for further details of the sales of Citigroup common stock to date. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 13 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20Transactions%20Report%20as%20of%2010-29-10.pdf).

*xxxix* This figure represents the $30.9 billion Treasury disbursed under the CPP, minus the $25 billion investment in Citigroup identified above, $13.95 billion in repayments (including the amount repaid for the Citigroup investment) that are in “repaid and unavailable” TARP funds, and losses under the program. This figure does not account for future repayments of CPP investments and dividend payments from CPP investments. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report for the Period Ending October 29, 2010, at 13 (Nov. 2, 2010) (online at financialstability.gov/docs/transaction-reports/11-2-10%20Transactions%20Report%20as%20of%2010-29-10.pdf).

*xxi* On November 9, 2009, Treasury announced the closing of the CAP and that only one institution, GMAC, was in need of further capital from Treasury. GMAC, however, received further funding through the AIFP. Therefore, the Panel considers CAP unused. U.S. Department of the Treasury, Treasury Announcement Regarding the Capital Assistance Program (Nov. 9, 2009) (online at www.financialstability.gov/latest1g_11090909.html).
This page contains financial data and information related to the Troubled Asset Relief Program (TARP) and other federal reserve initiatives. The text includes references to various reports and publications by the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation (FDIC), and the U.S. Department of the Treasury. The information covers topics such as the Term Asset-Backed Securities Loan Facility (TALF), the asset-backed commercial paper money market mutual fund liquidity facility, and the Troubled Asset Relief Program (TARP). The data includes figures on loan amounts, investments, and other financial metrics as of specific dates, such as March 31, 2010, and October 29, 2010. The text also references the FDIC's Chief Financial Officer's Report to the Board: DIF Income Statement—Second Quarter 2010, and the FDIC's Board of Governors' Report to the Federal Reserve System: Factors Affecting Reserve Balances. The page also includes references to the FDIC's Chief Financial Officer's 2009 interim report and the FDIC's 2010 Annual Report. The data is presented in a clear and concise manner, allowing readers to understand the financial landscape of these programs and initiatives.
SECTION FOUR: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of the Emergency Economic Stabilization Act (EESA) and formed on November 26, 2008. Since then, the Panel has produced 24 oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's October oversight report, the following developments pertaining to the Panel's oversight of the TARP took place:

- The Panel held a hearing in Washington on October 21, 2010, discussing restrictions on executive compensation for companies that received TARP funds. The Panel heard testimony from Kenneth R. Feinberg, the former Special Master for TARP Executive Compensation, as well as from industry and academic experts.
- The Panel held a hearing in Washington on October 27, 2010. The Panel heard testimony from Phyllis Caldwell, chief of Treasury's Homeownership Preservation Office, as well as from industry and academic experts about Treasury's HAMP program and the effects of recent foreclosure documentation irregularities on Treasury's ability to maintain systemic financial stability and effective foreclosure mitigation efforts under the TARP.

Upcoming Reports and Hearings

The Panel will release its next oversight report in December. The report will discuss HAMP, the most expansive of Treasury's foreclosure mitigation initiatives under the TARP, assessing its effectiveness in meeting the TARP's legislative mandate to "protect home values" and "preserve homeownership." This will be the Panel's fourth report addressing Treasury's foreclosure mitigation efforts under the TARP.

Acknowledgements

The Panel would like to thank the following individuals for sharing their thoughts and suggestions: Roger Ashworth, MBS Analyst, Amherst Securities; Guy Cecala, CEO and Publisher, Inside Mortgage Finance; Chris Gamaitoni, Vice President, Compass Point Research & Trading; Jason Gold, Senior Fellow for Housing and Financial Services Policy, Third Way; Laurie Goodman, Senior Managing Director, Amherst Securities; Anne Kim, Domestic Policy Program Director, Third Way; Paul Miller, Managing Director and Group Head of Financial Services Research, FBR Capital Markets; Matthew O'Connor, Research Analyst, Deutsche Bank Securities; Christopher Peterson, Associate Dean for Academic Affairs and Professor of Law, University of Utah; Robert Placet, Associate Analyst, Deutsche Bank Securities; Joshua Rosner, Managing Director, Graham Fisher & Co.; and, Jason Stewart, Managing Director, Compass Point Research & Trading.

The Panel also wishes to acknowledge and thank the many individuals from the academic, legal, consumer, analyst, and other communities who provided useful information and views for this report.
SECTION FIVE: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating financial crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stability (OFS) within Treasury to implement the TARP. At the same time, Congress created the Congressional Oversight Panel to “review the current state of financial markets and the regulatory system.” The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury’s actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury’s actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes “the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers.” The Panel issued this report in January 2009. Congress subsequently expanded the Panel’s mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Director of Policy and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School, to the Panel. With the appointment on November 19, 2008, of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel. Effective August 10, 2009, Senator Sununu resigned from the Panel, and on August 20, 2009, Senator McConnell announced the appointment of Paul Atkins, former Commissioner of the U.S. Securities and Exchange Commission, to fill the vacant seat. Effective December 9, 2009, Congressman Jeb Hensarling resigned from the Panel and House Minority Leader John Boehner announced the appointment of J. Mark McWatters to fill the vacant seat. Senate Minority Leader Mitch McConnell appointed Kenneth Troske, Sturgill Professor of Economics at the University of Kentucky, to fill the vacancy created by the resignation of Paul Atkins on May 21, 2010. Effective September 17, 2010, Elizabeth Warren resigned from the Panel, and on September 30, 2010, Senate Majority Leader Harry Reid announced the appointment of Senator Ted Kaufman to fill the vacant seat. On October 4, 2010, the Panel elected Senator Kaufman as its chair.
APPENDIX I: LETTER FROM CHAIRMAN TED KAUFMAN TO SPECIAL MASTER PATRICIA GEOGHEGAN, RE: FOLLOW UP TO EXECUTIVE COMPENSATION HEARING, DATED NOVEMBER 1, 2010
November 1, 2010

The Honorable Patricia Geoghegan
Special Master for TARP Executive Compensation
United States Department of the Treasury
Room 1639
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Ms. Geoghegan:

On behalf of the Congressional Oversight Panel, thank you very much for your attendance at the Panel’s hearing on the TARP and executive compensation on October 21, 2010. The hearing served as an important opportunity for the Panel to learn more about the work of the Office of the Special Master, a subject the Panel will continue to examine in the months ahead.

In the course of the Panel’s review of this issue, it has identified several data issues that are important to its ability to conduct its oversight responsibilities. During the hearing, I requested that the former Special Master provide this information to the Panel. He responded that much of this information is available in the Final Report. However, some relevant details are not included in the report. Accordingly, the Panel requests your responses to the following questions:

- **Turnover**: How many employees left TARP exceptional assistance firms after the American Recovery and Reinvestment Act was passed? After the Interim Final Rule was passed in June 2009? After the Special Master issued his 2009 determinations? How does this data compare to expected turnover under “normal” conditions? In total, how many employees have left exceptional assistance firms as a result of the TARP’s executive compensation restrictions?

- **Individual compensation comparison**: How did the Special Master’s 2009 determinations for individual employees compare to their 2007 and 2008 salaries? The Special Master’s determination letters provide this information in the aggregate, but not at an individual level. Individual names are not necessary, so long as some basis for comparison (such as employee identification numbers) is provided.

- **2009 total compensation**: What was the total compensation that covered employees received between January 1, 2009 and December 31, 2009? How much did each employee receive during the period between June 15, 2009 and the Special Master’s determinations in October 2009?

http://www.house.gov
• 2010 total compensation: What is the total compensation that you anticipate covered employees will receive between January 1, 2010 and December 31, 2010?

• General Motors determinations: The Special Master's 2009 determination letter for General Motors does not provide employee ID numbers, making it difficult to compare individual employee compensation in 2009 and 2010. How did compensation for individual employees at General Motors change between 2009 and 2010?

The Panel seeks written responses to these questions by November 15, 2010. I would be happy to answer any questions about this letter that you may have. If you would prefer, a member of your staff may contact the Panel’s Executive Director, Naomi Baum, at

Sincerely,

[Signature]

Senator Ted Kaufman
Chairman
Congressional Oversight Panel

Cc: Dr. Kenneth Troske
Mr. J. Mark McWatters
Mr. Richard N. Neiman
Mr. Darren A. Silvers