Apocalypse Now? Will The Massachusetts Ibanez Case Unravel Widespread Irregularities In The Residential Securitized Mortgage Market?

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Barely 24 hours old — the Massachusetts Supreme Judicial Court's *U.S. Bank v. Ibanez* decision is already a huge national story. CNN-Money calls it a "beat down" of the big banks. Reuters says its a "catastrophe risk" for banks. The Huffington Post claims there's some Obama Administration-Bank of America conspiracy in play. The ruling has spooked investors, as bank stocks were down in reaction to the ruling.

The case certainly has national implications as the SJC is the first state supreme court to weigh in on this particular issue, and the majority of states have laws similar to Massachusetts' regarding the assignment of mortgages, such as California and Georgia. Other courts across the country will likely be influenced by the ruling, and the SJC is widely regarded as one of the most respected state supreme courts in the country.

But is the *Ibanez* ruling really the next **Foreclosure Apocalypse**?

That remains to be seen. But the answer to the question will likely rest with what has transpired under complex **mortgage securitization pooling and servicing agreements**, known as PSA's. These complex agreements may unlock the key to who, if anyone, owns these non-performing mortgage loans and has the legal right to foreclose.

The Ibanez Fact Pattern: Mortgage Assignments In Blank, A Common Practice

On December 1, 2005, Antonio Ibanez took out a $103,500 loan for the purchase of property at 20 Crosby Street in Springfield, MA secured by a mortgage to the lender, Rose Mortgage, Inc. The mortgage was recorded in the county registry of deeds the following day. Several days later, Rose Mortgage executed an assignment of this mortgage in blank, that is, an assignment that did not specify the name of the assignee. The blank space in the assignment was at some point stamped with the name of Option One Mortgage Corporation (Option One) as the assignee, and that assignment was recorded in the registry of deeds on June 7, 2006. Before the recording, on January 23, 2006, Option One also executed an assignment of the Ibanez mortgage in blank.

Option One then assigned the Ibanez mortgage to Lehman Brothers Bank, FSB, which assigned it to Lehman Brothers Holdings Inc., which then assigned it to the Structured Asset Securities Corporation, which then assigned the mortgage, pooled with approximately 1,220 other mortgage loans, to U.S. Bank, as trustee for the Structured Asset Securities Corporation Mortgage Pass-Through Certificates, Series 2006-Z. With this last assignment, the Ibanez and other loans were pooled into a trust and converted into a mortgage-backed securities pool that was bought and sold by investors.

On April 17, 2007, U.S. Bank started a foreclosure proceeding in Massachusetts state court. Although Massachusetts requires foreclosing lenders to follow the Soldier's and Sailor's Servicemember's Act to ensure the debtor is not in the military, it is considered a non-judicial foreclosure state. In the foreclosure complaint, U.S. Bank represented that it was the "owner (or assignee) and holder" of the Ibanez mortgage. At the foreclosure sale on July 5, 2007, the Ibanez property was purchased by U.S. Bank, as trustee for the securitization trust, for $94,350, a value significantly less than the outstanding debt and the estimated market value of the property.

On September 2, 2008--14 months after the foreclosure sale was completed – U.S. Bank obtained an assignment of the Ibanez mortgage.

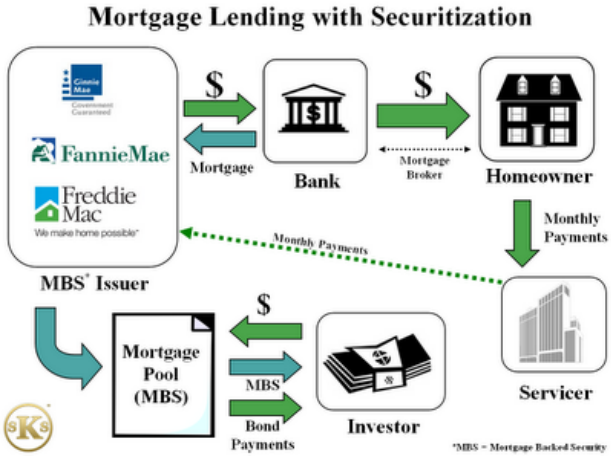
The major problem was that as the time U.S. Bank initiated the foreclosure proceeding, it did not possess (and could not produce evidence of) a legally effective mortgage assignment evidencing that it held the Ibanez mortgage.

Securitized Pooling and Servicing Agreements

Almost all sub-prime mortgages and millions of conventional mortgages originated before the mortgage meltdown in 2008 were packaged in securitized mortgage securities and sold off to Wall Street investors. Securitized mortgages currently comprise over half, or $8.9 trillion, of the $14.2 trillion in total U.S. mortgage debt outstanding.

Pooling and Servicing Agreements are part of the complex mortgage securitization lending agreements. As one securitization expert explains, a Pooling and Servicing Agreement is the legal document creating a residential mortgage backed securitized trust. The PSA also establishes some mandatory rules and procedures for the sales and transfers of the mortgages and mortgage notes from the originators to the securitized trusts which hold the millions of bundles of mortgage loans.

The Ibanez Ruling: Prohibits Assignments In Blank



The *Ibanez* ruling clearly invalidates a common practice in the sub-prime mortgage securitization industry of assigning the promissory note and mortgage in blank and not recording it until after the foreclosure process has started. The Court held that there must be evidence of a valid assignment of the mortgage at the time the foreclosure process starts which would establish the current ownership of the mortgage.

Left open by the Court was what evidence would suffice to establish such ownership, specifically referencing PSA's:

"We do not suggest that an assignment must be in recordable form at the time of the notice of sale or the subsequent foreclosure sale, although recording is likely the better practice. Where a pool of mortgages is assigned to a securitized trust, the executed agreement that assigns the pool of mortgages, with a schedule of the pooled mortgage loans that clearly and specifically identifies the mortgage at issue as among those assigned, may suffice to establish the trustee as the mortgage holder. However, there must be proof that the assignment was made by a party that itself held the mortgage."

This language opens the door for Massachusetts foreclosing lenders to move ahead with foreclosures and cure title defects by using PSA's to prove proper assignment of the mortgage loans. That is, if they can produce proper documentation that the defaulting mortgage was actually transferred into the pool and assigned to the end-holder before the initiation of foreclosure proceedings. Whether lenders can do this is another story.

Have Lenders Complied With The PSA's?

The major problem for banks is mounting evidence is that originating lenders never transferred a vast number of loans into the securitized trusts in the first place. Josh Rosner, a well respected financial analyst, issued a client advisory in October 2010, advising of widespread violations of pooling and servicing agreements on mortgages. Mr. Rosner counseled that although PSA's require transfer of the promissory notes into the securitized trusts, that hardly ever occurred in the white hot run-up of securitized loans in the last decade. He also says that the mortgage assignments which must accompany each note are routinely ignored or left blank. (This was the major problem in the *Ibanez* case).

Mr. Rosner said:

"We believe nearly every single loan transferred was transferred to (securitized trusts) in "blank" name. That is to say the actual loans were apparently not, as of either the cut-off or closing dates, assigned to the (securitized trusts) as required by the PSA."

Mr. Rosner concludes in this chilling statement:

"There have been a large numbers of foreclosure proceedings where, because of improper assignments, the trust has been unable to demonstrate the right to foreclose. It is thus that we raised concern about the transfer "in blank name." We do believe it likely the rush to move large volumes of loans may well have resulted in operational failures in the "true sale" process by some selling firms and trustees. Were this "missing assignment" problem, which we are witnessing in individual foreclosure proceedings, to be found to have resulted from widespread failure of issuers and trusts to properly transfer rights there would be appear to be a strong legal basis for the calling into question securitizations."

Mr. Rosner's theory has been born out in court testimony. In a New Jersey bankruptcy case, a senior Bank of America manager admitted that Countrywide Loans routinely failed to transfer promissory notes as part of the securitization process. Countrywide, of course, went under but not after originating billions in loans.

But only the *banks themselves* have a handle on how widespread these irregularities are.

Apocalypse Now?

If, in fact, there exists widespread legal failure of securitized mortgage pools, as Mr. Rosner, theorizes, then we are possibly facing the **Apocalypse Scenario,** calling into question the legal and financial soundness of the vast majority of the existing sub-prime mortgage market and potentially even a large portion of the U.S. securitized mortgage market. Securitized mortgages comprise over half, or $8.9 trillion, of the $14.2 trillion in total U.S. mortgage debt outstanding.

"It may mean investors who think they bought mortgage- backed securities bought securities that aren't backed by anything," said Kurt Eggert, a professor at Chapman University School of Law in Orange, California. Well, that's already happened. Take a look at this lawsuit by MBIA Insurance against Credit Suisse over a bad securitization loan deal.

Before the Ibanez ruling came down Bloomberg News said the best scenario is that the disputes are deemed as legal technicalities, which would cause a one-year delay in foreclosures. In the medium case, years of litigation will ensue. In the worst case, the problem becomes systemic, causing "the mortgage market to grind to a halt as title insurers refuse to insure mortgages involving existing homes."

Well, we now know from the *Ibanez* decision that this is hardly a "legal technicality." So we are in the medium or worst case scenarios.

For those thousands (or millions?) of defaulted loans which were "assigned in blank," I'm simply not sure if or how mortgage lenders are going to be able to cure the title defects they created. It's going to take some major effort and creative lawyering, that's for sure.

Don't Believe The Hype?

Not all investment analysts, however, expect financial chaos. The controversy may cause a six-month delay in foreclosures and "have a muted effect on valuation" of about $154 billion of mortgage-backed securities, Laurie Goodman, senior managing director of Amherst Securities Group LP in New York, wrote in a note to investors. "Servicers will incur high costs both from re-processing loans that are in the process of foreclosure as well as from defending themselves in litigations," Goodman wrote. "And investors definitely need to question the cash flows they are receiving on private-label MBS, to ascertain that they are not paying for expenses that rightfully belong to servicers."

How many pools of mortgage loans are affected by the "assignment in blank" and related irregularities in the servicing pools? I haven't been able to find any firm data.

For the sake of our economy, I hope that this mess can be fixed at minimal cost to taxpayers and distressed homeowners alike!