

# **Doron F. Eghbali Banking Law**

## **How Banks Paradoxically Benefit from Holding Junior Mortgages**

**Friday, February 12, 2010 by [Doron F. Eghbali](#)**

Many of us thought the tax-payer funded bank bailouts of last two years would be over by now. Nonetheless, the government programs to help homeowners with their first mortgages are benefiting banks.

### **BACKGROUND**

Theoretically, junior or "second lien" mortgages stand behind the first mortgage and take a loss in any workout with lenders aimed at assisting homeowners. However, government programs, aimed at making the first mortgages less expensive and affordable for homeowners, do not make significant changes to junior mortgages.

The unintended result is borrowers have more money in hand. This small amount of money helps out borrowers make payments on the second mortgage. This would mean the banks, holders of such loans, would get another bailout for free.

This is important to note bond investors who hold mortgage-backed securities and tax-payer funded Fannie Mae and Freddie Mac, hold FIRST mortgages. However, junior mortgages are usually and exclusively held by banks.

### **BANKS BENEFIT AND TAXPAYERS SUFFER**

It is important to note such paradox makes tax payers suffer the consequences of bank actions in making bad loans while banks get to further benefit from the housing morass at taxpayers' expense.

### **BENEFITS FOR BANKS**

#### **1. Free Bailout**

As indicated before, junior loans remain unmodified even after the first mortgage is modified thanks to government lackluster and mostly ineffective programs.

#### **2. Every Penny Counts**

Banks hold junior mortgages as a cluster of huge portfolios. As such, any paltry benefit would benefit them.

## **SECOND-MORTGAGE MODIFICATION BY BANKS**

This is important to indicate banks point out that they have been modifying second mortgages of their own accord. The problem with this contention is that banks other than Bank of America, have not provided data to corroborate such contention.

In addition, the government has instituted a program to modify junior mortgages. However, there is no requirement to join. In fact, Bank of America is the only major national bank to have voluntarily joined.

Unfortunately, the government has lost its leverage to exert any pressure on other banks, as large banks have paid back the Troubled Asset Relief Program funds.

## **WHAT TO EXPECT**

If the unemployment rate does not significantly and relatively swiftly improve, a blizzard of more foreclosures would force policy makers to seriously address this important concern.