When Securitization Complicates the Issue: What Are the Homeowner’s Defenses to Foreclosure?

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Table of Contents

I. Introduction ........................................................... 300

II. Origins of the Mortgage Foreclosure Crisis ............................................. 302
    A. Deregulation ........................................................................... 302
    B. Securitization and the Rise of the Shadow Banking Sector............ 305
    C. Foreclosure ............................................................................ 308
    D. Legal Issues ........................................................................... 310

III. Litigation Solutions ................................................................. 311
    A. The Standing "Defense" .............................................................. 311
        1. Dismissal: When There is No Documentation
           of Assignment of the Note and Mortgage ......................... 314
        2. Sanctions: When the Mortgage Assignment
           is Misrepresented to the Court ............................................. 317
        3. Tougher Solutions: When the Plaintiff is Not
           the Holder in Due Course .................................................... 318
           a. Standing Will Incentivize Loan Renegotiation ............. 320
    IV. Legislative Solutions ............................................................ 321
        A. Loan Servicers Can Renegotiate Loans by Contract Right.... 323
        B. Who Should Facilitate Loan Renegotiation? ....................... 324
           1. Private Loan Modification is Idealistic ....................... 324
           2. State Laws Are Preempted .............................................. 326

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3. Federal Laws Can Incentivize Servicers
to Modify Loans ..................................................327
   a. A Statutory Fiduciary Duty to Bondholders ..........327
   b. Revive the Home Owners’ Loan Corporation .......327

V. Conclusion ......................................................................328

Fluidity of the market—X dollars
Contractual arrangements between institutions and counsel—X dollars
Purchasing mortgages in bulk and securitizing—X dollars
Rush to file, slow to record after judgment—X dollars
The jurisdictional integrity of the United States District Court—Priceless.

—Judge Christopher A. Boyko,
United States District Court
Northern District of Ohio

I. Introduction

Since the housing market peaked in 2006, American home values have fallen twenty percent across the country. As a result of declining home equity, one in ten Americans with mortgages are in financial trouble. Six million Americans with outstanding subprime loans are at

1. In re Foreclosure Cases, No. 1:07cv2282, et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007) [hereinafter Boyko].
4. Id.
5. A subprime loan is generally defined as a loan given to a buyer who would not otherwise qualify for a prime loan. Reform Foreclosure, Predatory Mortgage and Payday Lending in America’s Cities Before the H. Comm. on Oversight and Government, 110th
risk of defaulting.\textsuperscript{6} As homeowners go into default, lenders rush into court to foreclose.\textsuperscript{7} As more homes remain vacant in neighborhoods, the housing value of entire neighborhoods decreases further in a vicious cycle.\textsuperscript{8} These figures suggest that the mortgage foreclosure crisis is not a self-contained problem.\textsuperscript{9}

Part I of this Note discusses the origins of the mortgage foreclosure crisis. Specifically, it tracks the path of a mortgage from securitization to foreclosure. It highlights the legal issues that arise when a trustee in possession of toxic securities backed by mortgages that are currently in default wants to instigate foreclosure proceedings. Part II addresses defaulting mortgagors’ standing defense to foreclosure proceedings instigated by trustees holding securitized mortgages. It argues that this defense is not only a technical defense, but it is also a direct way to confront the legal issue caused by the securitization of mortgages when it comes time to collect: Who has the right to foreclose? Part III examines the ways that legislation can incentivize loan servicers to renegotiate

Cong. 4 (2007), (testimony of Josh Nassar, Center for Responsible Lending), available at http://oversight.house.gov/documents/20070322175553-40982.pdf. To offset the risk, subprime loans generally carry higher interest rates than prime loans offered to creditworthy borrowers and charge additional fees. \textit{Id}. All subprime loans are not predatory. \textit{Id}. This Note will not distinguish between defenses available to homeowners who have defaulted on predatory loans versus those who have defaulted on non-predatory loans.


7. \textit{See} Boyko, No. 1:07cv2282, et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007) (discussing that the lenders’ decisions to file for foreclosure as fast as possible is driven by monetary concerns).

8. \textit{See} Center for Responsible Lending, \textbf{PERMITTING JUDICIAL MODIFICATION OF HOME LOANS WOULD SAVE 600,000 HOMES—PURCHASE OF SECURITIES WILL NOT SAVE ANY 1} (Sept. 19, 2008), http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/crl-judicial-mod-of-home-mortgages-brf.pdf (supporting the proposition that when families cannot pay their loans, foreclosures increase, causing neighborhoods go into decline, causing more financial institutions to go under, causing even more foreclosures).

9. Although, undoubtedly, foreclosures disproportionately affect low-income and minority communities who were specifically targeted by subprime mortgage lenders. \textit{See} e.g., Debbie Gruenstein Bocian, Keith S. Ernst & Wei Li, \textbf{CENTER FOR RESPONSIBLE LENDING, UNFAIR LENDING: THE EFFECT OF RACE AND ETHNICITY ON THE PRICE OF SUBPRIME MORTGAGES} 4–5 (May 31, 2006), http://www.responsiblelending.org/mortgage-lending/research-analysis/rfr011-Unfair_Lending-0506.pdf (noting that several research analyses of subprime mortgage data revealed that "African-American and Latino borrowers received a disproportionate share of higher-rate [subprime] home loans, even when controlling for factors such as borrower income and property location").
mortgages that are at risk of default. It argues that federal legislation may offer a more permanent solution to the mortgage foreclosure crisis.

This Note concludes that a case-by-case approach to the mortgage foreclosure crisis, or a solution that relies on litigating individual claims as mortgagors go into default, is admirable because it assigns the costs of securitization to one party—the trustee—and only in cases in which the trustee of the securitized mortgage has brought a foreclosure action wrongfully in violation of true sale requirements. It narrowly targets only wrongdoers by dismissing foreclosure proceedings when the trustee lacks standing. However, litigating claims individually does not provide enough incentive to trustees to settle claims before coming to court; therefore, it is not a proactive or permanent solution.

By contrast, when a third party, such as a governmental entity, assumes the costs of securitization, all parties—the trustee, the loan servicer, and the mortgagor—are incentivized to renegotiate the terms of the underlying mortgage. While the loan servicer and the mortgagor can enter into loan renegotiation voluntarily, thereby dividing the costs of securitization between these two parties, in reality the trustee has no incentive to do so for fear of lawsuits by holders of securitized debt instruments. By enacting legislation that defines the liability of servicers to the holders of the securitized notes, servicers will be incentivized to renegotiate loans because there will be no hidden costs. Finally, either option is preferable to the current system where the homeowner is stuck paying for the costs of securitizing her mortgage.

II. Origins of the Mortgage Foreclosure Crisis

A. Deregulation

The current mortgage foreclosure crisis was precipitated by the liberal policies of financial regulators and the governments who facilitated the climate of deregulation on Wall Street beginning in the 1980s.10

10. See Robert Wade, Financial Regime Change?, 53 NLR 5, 12 (2008) ("It is no exaggeration to say that the crisis stems from the biggest regulatory failure in modern history."). Wade uses the term "neoliberalism" to label the economic model in place from 1975 to 2008 that encouraged governments to liberalize, privatize, and deregulate as part of financial globalization. Id. at 5. But Peter Gowan notes that in addition to the neoliberalism theory espoused by Wade, there is the "accidents" theory which blames the crisis on the negligent interplay of Greenspan’s Federal Reserve, banks, regulators, and ratings agencies. Peter Gowan, Crisis in the Heartland: Consequences of the New Wall Street System, 55 NLR 5, 19–20 (2009). Gowan’s thesis, however, rejects both the neoliberal and accidents
Deregulation\textsuperscript{11} enabled financial institutions to carry high debt-to-equity ratios,\textsuperscript{12} create complex financial instruments,\textsuperscript{13} and trade those instruments in opaque markets.\textsuperscript{14} By the 1980s, with the aid of Washington, the financial services industry had repositioned itself atop a new global capitalist structure, and its importance in the new structure was reinforced from within it by new actors, new practices, and new dynamics created in the increasingly global world of finance.\textsuperscript{15} Specifically, deregulation and lower interest rates encouraged the rise of the lender-trader model, speculative arbitrage, highly leveraged banks, the shadow banking sector (and with it, new types of securities), speculative trading in asset bubbles, and reliance on credit derivatives.\textsuperscript{16}

\begin{footnotesize}
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\item theories and argues that that the new structure of Wall Street was not haphazard at all, but was an orchestrated complex system that was preordained to fail because government no longer regulated securities that were inherently flawed. \textit{Id.} at 20–21.
\item For a list of twelve deregulatory steps that led to the financial meltdown, see Robert Weissman \& James Donahue, \textit{Consumer Education Foundation, Sold-Out: How Wall Street and Washington Betrayed America} (Mar. 2009), \textit{www.wallstreetwatch.org/reports/sold_out.pdf}. The twelve steps Weissman lists are: (1) the repeal of Glass-Steagall, (2) off-the-books accounting for banks, (3) preventing the Commodities Future Trading Commission from regulating derivatives, (4) financial derivative deregulation under the Commodities Futures Modernization Act, (5) removal of SEC capital limits on investment banks, (6) weak capital reserve requirements for banks under Basel II, (7) failure to police predatory lending, (8) federal laws that preempted state policing of predatory lending, (9) failure to hold assignees of mortgages liable, (10) Fannie Mae and Freddie Mac’s insuring subprime mortgages, (11) bank merger mania which created a too-big-to-fail mentality, and (12) the failure of credit ratings agencies to properly inform investors about risk. \textit{Id.} at 21–98.
\item See Wade, \textit{supra} note 10, at 12 ("[I]t was acceptable in the eyes of the authorities for investment banks to operate with a debt to equity ratio of 30–35:1."). In 2004, the Securities and Exchange Commission (SEC) relaxed the net-capital rule. Gowan, \textit{supra} note 10, at 15. The result of this was that investment banks were allowed to decide their own leverage. \textit{Id.}
\item See Wade, \textit{supra} note 10, at 12 (describing this model of banking as encouraging "high leverage, complex financial instruments and opaque markets, all of which put this crisis in a league of its own").
\item See Gowan, \textit{supra} note 10, at 6 (labeling the financial structures, actors, practices, and dynamics that came about in the wake of neoliberal policies as the "New Wall Street System").
\item See \textit{id.} at 7–8 (identifying these six major policies as the foundation of the "New Wall Street System").
\end{itemize}
\end{footnotesize}
In the late 1990s, deregulation, which had passively contributed to the creation of the new structure of Wall Street, became an actively pursued governmental policy within the global financial services industry, largely due to the five billion dollars spent by Wall Street from 1998–2008 on lobbying the government to deregulate.\footnote{See Weissman, supra note 11, at 99 (noting that the financial sector as a whole spent more than $1.738 billion on federal election campaign contributions between 1998 and 2008). An additional $3.3 billion was spent on officially registered lobbyists during the same time period.} In 1997, then-Chancellor of the Exchequer Gordon Brown set up the UK Financial Services Authority, a body that assumed jurisdiction over bank regulation (or more aptly, the lack thereof).\footnote{Gowan, supra note 10, at 16.} The resulting "light-touch regulation"\footnote{The Financial Services Authority operated by the principal that Wall Street banks could regulate themselves. Id. As a result, London became "the place where you could do abroad what you could not do back home [in New York]; in this instance, a location for regulatory arbitrage." Id.} was the culmination of the UK’s plan to lure financial business away from New York a plan that dates back to the Thatcher government.\footnote{See Wade, supra note 10, at 12 (discussing the United Kingdom’s often underemphasized role in the financial crisis).} Prompting a reply from Washington, in 1999, the United States Senate and House of Representatives repealed the Glass-Steagall Act,\footnote{See Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106–102, 113 Stat. 1338 (1999) (repealing part of the Glass-Steagall Act of 1933, 48 Stat. 162 (1933) (codified in scattered sections of 12 U.S.C.), which separated commercial banking activities from investment banking activities). For Congressional intent behind passing the Glass-Steagall Act, see S. REP. NO. 73–77, at 18 (1933). Congress was concerned with the subtle hazards that occur when a commercial bank enters the investment banking business and ceases to merely be a fiduciary agent. Id.} casting it aside as a relic of depression-era regulation that was no longer needed.\footnote{See Wade, supra note 10, at 12 (describing those who viewed the Glass-Steagall Act as an "onerous" regulation and noting that political momentum grew in the 1990s to repeal it).} The effect was "de facto financial liberalization."\footnote{See id. (arguing that gutting the Glass-Steagall Act allowed banks to engage in commercial banking, underwriting, and investment banking). See generally Stephen Labaton, Congress Passes Wide-Ranging Bill Easing Bank Laws, N.Y. TIMES, Nov. 5, 1999, at A1 (describing briefly arguments for and against the Gramm-Leach-Bliley Act).} The structure of the new Wall Street was not only reinforced from within the financial services industry by new products and dynamics,\footnote{See Gowan, supra note 10, at 7–8 (identifying the major policies as the rise of the lender-trader model, speculative arbitrage, maximizing leverage, the rise of the shadow} but it was also fully supported by the United States government.\footnote{Id.}
B. Securitization and the Rise of the Shadow Banking Sector

The securitization of mortgages and the rise of the shadow banking sector in particular have had important roles in the mortgage foreclosure crisis. When the Federal Reserve slashed interest rates in 2002, borrowing money became inexpensive and the home-lending industry profited by changing from an originate-to-own to an originate-to-lend business model. Mortgage originators stopped holding onto mortgages and started selling them to third parties, such as investment banks or government sponsored entities (GSEs), and used the capital to finance new mortgages. The mortgage originators were incentivized to sell the mortgages because they could make a profit quickly and distribute the risk of default to others. The documented rise in subprime lending exacerbated this cycle: Mortgage originators sought new customers to increase the profit they made from selling mortgages on the secondary market and mortgages became easier to obtain.

banking system and new types of securities, transformation of money markets into funders of speculative trading in asset bubbles, and the new centrality of credit derivatives).

25. See Gowan, supra note 10, at 20 (stating that over the course of American history there have been phases of tension between Wall Street and Congress as well as between Wall Street and the executive branch, but during the last twenty-five years all three entities have become well integrated).


27. See Gowan, supra note 10, at 13 (documenting how deregulation facilitated the rise of the shadow banking sector).


29. Id.

30. See Beitel, supra note 26 (“These instruments [MBSs] are today the major conduits of funding new mortgage loans, the vast majority of which are issued under expectation that they will be sold into the secondary mortgage market.”).

In order to make the mortgages appear less risky to third-party purchasers, mortgage originators obtained assurance from GSEs (e.g., Fannie Mae, Freddie Mac, and Ginnie Mae) certifying that the loans were prime.\textsuperscript{32} After they sold the guaranteed loans to investment banks, the banks pooled the mortgages together and issued a bond called a mortgage-backed security (MBS), whose yield was based on the amortization payments of the underlying mortgage debt.\textsuperscript{33} The banks then sold the MBSs into a secondary market to wealthy or institutional investors (such as pension funds) and made money by subtracting a servicing fee for underwriting the debt.\textsuperscript{34}

In addition to government-guaranteed MBSs, private firms also issued private label MBSs, typically with some form of credit enhancement to obtain a higher credit rating.\textsuperscript{35} However, throughout the 2000s, firms issued private label MBSs with little or no credit enhancement that were stamped with the same high credit ratings.\textsuperscript{36} The MBSs appeared to carry the same minimal risk, but were in fact much riskier than their earlier counterparts.\textsuperscript{37}

In order to obtain more cash and distribute the risk of default to more parties, banks created exotic securitized debt instruments such as collateralized debt obligations (CDOs).\textsuperscript{38} Financiers created CDOs by buying up a pool of subprime mortgages and segregating the cash flows into different tranches, each with different characteristics.\textsuperscript{39}

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\item See Gupta, supra note 28 (explaining that assurance "means one of the agencies certifies that the loans are creditworthy"). In 2004, to address low rates of home ownership among low-income populations and communities of color, Congress began encouraging GSEs to assure even subprime mortgages. \textit{Id.}
\item Id.
\item Beitel, supra note 26.
\item See Charles J. Goetz, Law and Economics 128 (1984) (discussing the process of credit enhancement by pooling risky investments). The policy behind pooling risk is based on the duty to diversify and expose the investor to both gains and losses: "Whatever the risks of any single investment, the risk-pooling effect . . . can be recognized as relevant to the duty to ‘diversify.’" \textit{Id.} Therefore, by adding more risk, \textit{if the risks are diverse}, there is negative covariance and risk is reduced. \textit{Id.} By implication, adding similarly risky loans with a positive covariance to a pool increases risk as swings in either direction become more pronounced. \textit{Id.} at 129.
\item See http://riskglossary.com/articles/mortage_backed_security.htm (last visited Sept. 23, 2009) (defining a mortgage-backed security as "a securitized interest in a pool of mortgages" and characterizing a mortgage-backed security as a "bond" (on file with Washington and Lee Journal of Civil Rights and Social Justice)).
\item See Goetz, supra note 35 and accompanying text.
\item See Beitel, supra note 26 (defining CDOs as investment trusts backed by mortgage pools).
\item See id. (explaining that tranches are "distinguished according to their level of
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tranches were then rated by ratings agencies based on their risk of default and rate of return: The higher the risk of default, the larger the yield.\footnote{Gupta, supra note 28.}

Because the ratings agencies approved and rated the tranches, purchasers of CDOs believed their investments were low risk, even though CDOs often only repackaged below investment-grade debt into tranches that were given AAA ratings.\footnote{Id. For a discussion of the "race to the bottom" and the role the ratings agencies played in the mortgage foreclosure crisis, see Elliot Blair Smith, Bringing Down Wall Street as Ratings Let Loose Subprime Scourge, BLOOMBERG, Sept. 24, 2008, available at http://www.bloomberg.com/apps/news?pid=20601109&sid=ah839JWTLPhs& (last visited Oct. 19, 2009) (on file with Washington and Lee Journal of Civil Rights and Social Justice).}

In theory, the lowest, unrated tranches (the riskiest) would absorb losses first and so on up the mezzanine of tranches, thereby insulating the highest-rated tranches from losses caused by debtors who defaulted on their mortgage loans.\footnote{See Beitel, supra note 26 (explaining that the lowest (unrated) tranche is the first to absorb losses, and additional losses are applied to the next tranche, and so on, up the ladder of tranches. This theoretically provides protection to the senior tranche, which receives the highest grade credit rating.).}

In order to increase leverage without increasing liability, banks created structured investment vehicles (SIVs) that issued asset-backed commercial paper (short-term debt) to raise money to buy CDOs.\footnote{See Gowan, supra note 10, at 13 (explaining that SIVs, hedge funds and private equity funds are not required to maintain a leverage ratio like banks are). But see Gupta, supra note 28 (discussing that even banks’ leverage ratios were not regulated after 2004 when the SEC loosened regulations on how much they could leverage against their capital reserves).}

SIVs were required to assure the commercial paper with a back-up line of credit in the event that the SIV could not pay.\footnote{See Beitel, supra note 26 ("To insure commercial paper will be accepted the SIV is required to secure a back-up line of credit from the sponsoring bank as insurance in the event that the SIV does not have sufficient cash on hand to settle these obligations at the time they come due.").}

As long as the money markets were confident that the mortgage borrowers

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\textit{WHEN SECURITIZATION COMPLICATES THE ISSUE}

307
were solvent, debts rolled over at maturity and everyone made money. But this model relied on the assumption that home values would keep rising. They did not.

From the beginning, these securitized debt instruments were highly risky for two reasons. First, there was no pricing mechanism for the instruments. Because there was no primary market for the instruments, their prices were determined by speculation alone and were blindly reinforced by ratings agencies. The ratings did not correspond to their riskiness. Second, there was no market price for the instruments because the source of the underlying collateral was unidentifiable after securitization. Because the underlying collateral was unidentifiable, the risk of default was not sufficiently accounted for in the securitization process.

C. Foreclosure

When the housing bubble burst, homeowners began to default, and widespread defaults impacted securitized debt instruments. The market for these debt instruments collapsed as buyers realized the risk involved in

47. See Beitel, supra note 26 ("If purchasers of this paper (the money market funds) are confident that borrowers are solvent, debts are typically rolled over at maturity at the prevailing interest rate. For this reason, the commercial paper issued by the SIVs did not initially create any additional liabilities for the sponsoring bank.").

48. See Gowan, supra note 10, at 5 (stating that the "notion that falling house prices could shut down half of all lending in the US economy within a matter of months . . . [made] no sense").

49. See Bair Testimony, supra note 2, at 729 (stating that by November 2008 home prices for the ten largest cities in the US had fallen 8.4 percent below 2007 levels and futures trading indexes pointed to further declines in 2009).

50. Gowan, supra note 10, at 18.

51. See id. ("The CDOs were typically written by the rating agencies, for a fee, and then given a Triple A rating by the same agency, for a second fee.").

52. See Beitel, supra note 26 ("Underwriting and monitoring standards deteriorated at all stages of the funding circuit.").

53. See Gowan, supra note 10, at 13 (explaining that mortgage-backed securities bundled thousands of unidentifiable mortgages together; therefore the credit-worthiness of the mortgage holders could no longer be a factor in the securities’ prices).

54. See Beitel, supra note 26 ("The proliferation of these new forms of securitized credit had not engineered risk out of the system of interlocking financial obligations.").

55. See Gupta, supra note 28 (noting that widespread mortgage defaults spread to structured debt instruments like CDOs and MBSs, causing the system of distributing risk to fail).
investing in mortgage-backed financial products. Banks hoarded cash in case they were called upon to pay for asset-backed commercial paper they had insured. Currently, investment banks find themselves holding onto “toxic” debt that they cannot get rid of because the underlying collateral is worthless.

The negative feedback loop in regional housing markets continues to be disastrous. As subprime mortgage holders default there are two noteworthy effects. First, investors and ratings agencies downgrade MBSs, which reduces the availability of credit to homebuyers, which decreases home sales. And second, as more homes are vacated, the prices of homes in entire neighborhoods decrease. Vacant houses become vulnerable to crime and squatters. As a result, many vacant homes in a single neighborhood can drive down the price of surrounding homes that are still occupied. The effect of foreclosures on neighborhoods in poor and minority communities, where subprime loans were more concentrated, is even more devastating.

56. See id. ("Securitization had spread across the entire financial system—investment and money banks, pension funds, central banks, insurance companies—putting everyone at risk.").

57. See Beitel, supra note 26 (explaining that when banks with SIVs realized they would either have to provide back-up lines of credit or sell off assets to retire maturing obligations, they were uncertain about the size and scale of their potential exposure and began to hoard funds).

58. Id.

59. See Gowan, supra note 10, at 18 ("When the Wall Street banks tried to off-load their CDOs, they found there was no market for them.").

60. Barr Testimony, supra note 2, at 730.

61. Id. at 729.


63. See Gupta, supra note 28 (explaining that the abandonment of homes creates ghost neighborhoods and drives down the price of still-occupied homes).

64. See Bocian, supra note 9, at 1 ("Our findings show that, for most types of subprime home loans, African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for legitimate risk factors.").
D. Legal Issues

The mortgage foreclosure crisis is at a precarious position in relation to the debt crisis of 2008: It is both a cause\(^{65}\) and an effect.\(^{66}\) In part, the industry's losses were inevitable as the housing bubble burst.\(^{67}\) In part, the crisis was triggered by a failure to curb predatory lending practices.\(^{68}\) But the securitization of home equity loans by private investment banks, especially the securitization of subprime, Alt-A, and other nontraditional loans, exacerbated the crisis by obfuscating legal responsibility on both ends of the mortgage.\(^{69}\)

A homeowner who cannot continue to pay her monthly mortgage payments (especially when they increase drastically) cannot drive to her local bank where she obtained her mortgage to renegotiate the terms of the loan because the mortgage originator no longer owns the mortgage outright; it has been assigned, securitized, and sold onto the secondary mortgage market without the homeowner's knowledge or approval.\(^{70}\) And private investment banks that are holding onto mortgage-backed securities in trust,
which are now worthless, are forced to decide whether they should renegotiate or instigate foreclosure proceedings.

Thus, a paradoxical situation has emerged in which trustees, the assignees of mortgages, are claiming the right to foreclose on mortgagors in default, but at the same time, are denying that they have enough rights in the underlying promissory note to renegotiate the terms of the loan. This problem can be solved with a two-prong approach involving litigation and federal legislation.

III. Litigation Solutions

Once the trustee instigates foreclosure proceedings, the obvious problem that faces defaulting mortgagors is defending their nonpayment. The second major hurdle for mortgagors (if they choose to litigate rather than default) is giving the plaintiff an incentive to settle. By enforcing standing requirements against plaintiff-lenders, courts can protect homeowners and incentivize the mortgage industry to record the assignment of obligations in a more responsible manner.

A. The Standing "Defense"

One defense that defendant-mortgagors can invoke in foreclosure proceedings, or the court can invoke sua sponte, is standing. To have

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71. See Eric Stein, Relieving Wall Street of Debt Does Not Translate Into the Right to Stop Foreclosures, CENTER FOR RESPONSIBLE LENDING, Sept. 24, 2008, http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/gov-ltd-power-to-modify-final.pdf (stating that "80% of subprime and Alt-A loans are securitized—the types of loans most likely to be distressed").

72. See Boyko, No. 1:07cv2282, et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007) (discussing lenders’ rush to foreclose when homeowners default).

73. But see Eggert, infra note 145 (stating that loan servicers arguably do have the power to renegotiate loans with individual homeowners).

74. Obviously, it is never too late to challenge a case of actual fraud, but bringing actions or asserting an affirmative defense to foreclosures based on fraudulent lending practices is outside the subject matter of this Note. For a discussion of the homeowner’s defenses to actual fraud, see Katherine Porter, Misbehavior and Mistake in Bankruptcy Mortgage Claims, 87 TEX. L. REV. 121, 133–40 (2008).

75. I will use the term plaintiff-lender generically. It does not refer to the plaintiff's status as the mortgage originator.

76. See Cent. States Se. & Sw. Areas Health & Welfare Fund v. Merck-Medco Managed Care, L.L.C., 433 F.3d 181, 198 (2d Cir. 2005) (stating that standing can be raised
standing before a federal court, a plaintiff must satisfy the standing requirements of Article III of the Constitution, which requires plaintiffs to show they have suffered an injury in fact. If a plaintiff does not satisfy this burden, the court must dismiss the action for lack of subject-matter jurisdiction. To have standing in a foreclosure action, a plaintiff-lender must show that it was the holder of the note and the mortgage at the time the complaint was filed and was harmed by the mortgagor’s failure to pay. Standing can be contested when there is no documented proof that the trustee was assigned both the underlying note and the mortgage. If the trustee decides to foreclose but does not have sufficient documentation of assignment of the note, assignment will not be presumed and the trustee will not be considered a holder in due course of the underlying collateral. As a result, the trustee will not be able to foreclose.

sua sponte because it involves the federal court’s subject matter jurisdiction (citing United States v. Quinones, 313 F.3d 49, 57–58 (2d Cir. 2002)).

77. See U.S. CONST. art. III (establishing the judicial branch of the U.S. government).

78. See id. § 2, cl. 1 (“The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution . . . .”); see also Loren v. Blue Cross & Blue Shield of Mich., 505 F.3d 598, 606–07 (6th Cir. 2007) (stating that in order to satisfy Article III’s standing requirements, the burden is on the plaintiff to show an injury in fact, harm caused by the defendant, and that it is likely the injury will be redressed by a favorable decision (citing Cleveland Branch NAACP v. City of Parma, 263 F.3d 513, 523–24 (6th Cir. 2001))).

79. See Loren, 505 F.3d at 607 (“If Plaintiff cannot establish constitutional standing, their claims must be dismissed for lack of subject matter jurisdiction.” (citing Cent. States Se. & Sw. Areas Health & Welfare Fund v. Merck-Medco Managed Care, 433 F.3d 181, 198 (2d Cir. 2005))).

80. See Midfirst Bank v. Davenport, No. 3:07-CV-405, 2007 WL 4246271, at *2 (S.D. Ohio Nov. 29, 2007) (“To show standing . . . in a foreclosure action, the plaintiff must show that it is the holder of the note and the mortgage at the time the complaint was filed.”). The foreclosure plaintiff must also show that he or she is harmed, “usually by not having received payments on the note.” Id.

81. Cf. Restatement (Third) of Prop.: Mortgages § 5.4 cmt. a (1997) (stating that the note and mortgage are separable, but the person who only owns the mortgage is unable to enforce it). The Restatement assumes that a transfer of the mortgage also transfers the obligation absent intent to the contrary. Id. cmt. c. Strictly following the Restatement gives the trustee the benefit of the doubt that the mortgage as well as the promissory was transferred without evidence of documentation showing they were purposefully separated. Id. However, the standing defense puts the onus on the trustee to show intent to transfer the entire obligation—the note and the mortgage—by demanding proper documentation. There is substantial contrary authority to support the rationale for the standing defense—that an assignment without the obligation is a nullity. See, e.g., In re Hurricane Resort Co., 30 B.R. 258, 261 (Bankr. S.D. Fla. 1983) (finding that the party instituting the foreclosure action failed to show actual assignment and possession of the underlying promissory note and therefore his assignment and claim of a secured lien was void as to the trustees in bankruptcy).

82. See Restatement (Third) of Prop.: Mortgages § 5.4 cmt. e (1997) ("[I]n
In fall 2007, federal courts in Ohio began to enforce the standing requirement draconically in foreclosure proceedings. In doing so, the courts called into question the common practice where lending institutions rush to file foreclosure actions, obtain default judgments, and collect interest on the judgments that go unpaid.  

In In re Foreclosure Cases, plaintiff-lender Deutsche Bank (DB) sought to foreclose on nineteen securitized residential mortgages that it held in trust. The court ordered DB to submit an affidavit showing it was either the original mortgage holder or the assignee, trustee, or successor-in-interest to the mortgage holder in each foreclosure proceeding. In ten of the cases, the note and mortgage attached to each complaint identified the lender as the original lending institution, not DB. In four of the other

general, a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation."

83. See Boyko, No. 1:07cv2282, et al., 2007 WL 3232430, at *1–3 (N.D. Ohio Oct. 31, 2007) (dismissing fourteen foreclosure proceedings for lack of standing); In re Foreclosure Actions, No. 1:07cv1007, et al., 2007 WL 4034554, at *1 (N.D. Ohio Nov. 14, 2007) [hereinafter O’Malley] (dismissing thirty-two foreclosure proceedings for lack of standing); In re Foreclosure Cases, 521 F. Supp. 2d 650, 654 (S.D. Ohio 2007) (ordering twenty-seven plaintiffs to submit evidence showing that they had standing and that the court had diversity jurisdiction or the court would dismiss their foreclosure cases).

84. See Boyko, 2007 WL 3232430, at *3 n.3 (discussing that the lenders’ decisions to file for foreclosure as fast as possible are driven by monetary concerns). Judge Boyko’s footnote three analogy (cited in the heading to this Note) shows that he believed that the holders of securitized mortgages should not receive the benefit of the doubt in court to save them transaction costs when their purchasing the securitized mortgages without paying a transaction cost is the root of the problem. Id.

85. See id. at *1–3 (N.D. Ohio Oct. 31, 2007) (dismissing the foreclosure complaints because plaintiff-lenders failed to satisfy their burden for demonstrating standing and failed to meet the requirements of diversity jurisdiction).

86. See Clients & Friends Memo from Cadwalader, Wickersham & Taft, L.L.P. at 2 (Nov. 16, 2007), http://www.cadwalader.com/assets/client_friend/111607ForeclosureCM.pdf [hereinafter Cadwalader Memo] ("Between July and October 2007, the plaintiffs, trustees of securitization trusts, filed nineteen complaints against mortgagees who had defaulted on their residential mortgages that had been sold into securitization trusts.").

87. See Boyko, 2007 WL 3232430, at *1 ("The Court’s Amended General Order . . . requires Plaintiff to submit an affidavit along with the Complaint, which identifies Plaintiff either as the original mortgage holder, or as an assignee, trustee or successor-in-interest.").

88. See id. ("[T]he attached Note and Mortgage identify the mortgagee and promisee as the original lending institution—one other than the named Plaintiff."); see also Cadwalader Memo, supra note 86, at 2 (stating that none of the ten cases where the mortgage assignments occurred after the complaint was filed showed the named Plaintiff to be the owner of the rights, title and interest as of the date of the complaint). The assignments merely expressed a present intent to convey all the rights, title and interest and the accompanying note to the plaintiff. Id.
cases, DB failed to file any executed assignments showing it was the holder of the notes and mortgages as of the date the complaints were filed.\textsuperscript{89} Because DB could not satisfy its burden of demonstrating it had suffered an injury in fact from nonpayment of the mortgages without documentation of assignment, Judge Boyko of the U.S. District Court for the Northern District of Ohio dismissed these fourteen complaints without prejudice on the grounds that DB did not have standing to sue.\textsuperscript{90}

This two-prong documentation requirement was further clarified two weeks later by Judge O’Malley, also of the Northern District of Ohio, who dismissed thirty-two foreclosure actions because the plaintiffs failed to prove they were the trustees or assignees of the mortgages.\textsuperscript{91} Sufficient documentation for plaintiffs who hold securitized mortgages as trustees was defined explicitly as "trust and/or assignment documents executed before the action was commenced, or both as circumstances may require."\textsuperscript{92} In other words, the plaintiff in a foreclosure proceeding is responsible for showing (1) that the mortgagee and the plaintiff intended to assign both the mortgage and the note to the plaintiff and (2) did in fact do so before the plaintiff brought an action to foreclose.

I. Dismissal: When There is No Documentation of Assignment of the Note and Mortgage

The holding of \textit{In re Foreclosure Cases} is narrow.\textsuperscript{93} Judge Boyko did not have any reason to believe that the obligations were not assigned to DB,\textsuperscript{89} See Cadwalader Memo, \textit{supra} note 86, at 2 ("In the other four cases, no mortgage assignments were presented by the court’s deadline.").

\textsuperscript{90} See Boyko, 2007 WL 3232430, at *1 ("After considering the submissions, along with all the documents filed of record, the Court dismisses the captioned cases without prejudice.").

\textsuperscript{91} See O’Malley, No. 1:07cv1007, et al., 2007 WL 4034554, at *1 (N.D. Ohio Nov. 14, 2007) (dismissing foreclosure actions because the plaintiff was not identified on the note as the original holder and has either not filed adequate documentation demonstrating original ownership or filed documentation indicating that an assignment occurred before the filing of the complaint).

\textsuperscript{92} Id. Judge O’Malley further stated that "an affidavit alone, in which the affiant attests that the plaintiff is the owner and holder of the note and mortgage, is insufficient . . . " \textit{Id. But see} Bank of New York v. Stuart, No. 06CA008953, 2007 WL 936706, at *2-3 (Ohio App. 9 Dist. March 30, 2007) (finding that the plaintiff-lender had standing to bring a foreclosure action against the defendant even though the assignment of the note did not take effect until five months after the date of the complaint because the assignor would have been precluded from bringing suit).

\textsuperscript{93} See Cadwalader Memo, \textit{supra} note 86, at 1 ("Although the cases appear to have
only that the bank’s records were sloppy. By implication, if the good faith of DB had been in question, the court would have required documentary proof to determine whether the mortgage originator and DB entered into a true sale rather than relying on DB’s word. Furthermore, the mortgagors could not be expected to know to whom they owed payments. The court dismissed ten of the cases because it had no documents showing that the mortgages had been assigned to DB at all. Notably, the court did not dismiss five of the cases where the mortgage assignments were executed and recorded before the complaints were filed. Judge Boyko’s opinion raised concern among secondary market participants, the holding of In re Foreclosure Cases is narrow and limited.

94. See Boyko, 2007 WL 3232430, at *2 ("The Assignments, in every instance, express a present intent to convey all rights, title and interest in the Mortgage and the accompanying Note to the Plaintiff named in the caption of the Foreclosure Complaint upon receipt of sufficient consideration on the date the Assignment was signed and notarized."). The court indicated that it did not doubt that the plaintiff owned the assignments, but stressed that DB must show the court that the purchase agreement was "executed as of the date of the Foreclosure Complaint." Id. (emphasis added).

95. Judge Boyko’s rationale departs from the reasoning of the Restatement of Mortgages, which assumes that the common intent of mortgagors and assignees is to keep the mortgage and obligation together when assigning them. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4 cmt. a (1997) ("It is conceivable that on rare occasions a mortgagor will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed. The far more common intent is to keep the two rights combined."). Therefore, the Restatement only requires determining intent in a situation where the mortgagor intentionally disassociated the mortgage and the obligation, whereas Judge Boyko shifted the burden onto the assignee to prove that it was a bona fide purchaser rather than assuming as such. See Boyko, 2007 WL 3232430, at *1 (ordering plaintiff-lenders to file a copy of the executed assignment demonstrating that they were the holders and owners of the note and mortgage).

96. See Boyko, 2007 WL 3232430, at *2 (noting the importance of documenting mortgage assignments of real property in writing). This is a real problem from the mortgagor’s perspective even in situations where the mortgagor is not in default. For a fact pattern illustrating how easily a defendant-mortgagor can be confused as to whom she is supposed to pay her mortgage, see Washington Mutual Bank, F.A. v. Green, 806 N.E.2d 604, 605 (Ohio Ct. App. 2004).

97. See Cadwalader Memo, supra note 86, at 2 (stating that the ten cases where the mortgage assignments occurred after the complaint was filed did not show the plaintiff to be the owner of the rights, title and interest under the mortgage at issue); see also Boyko, 2007 WL 3232430, at *1 (finding that the notes and mortgages identify the mortgagee and promisee as the original lending institution rather than the plaintiff and that there is no reference to the plaintiff in the recorded chain of title). Indeed, sloppy paperwork accounted for the lack of proof of executed assignments. Id. In ten cases, the assignments were not executed as of the date of filing the Complaint. See Cadwalader Memo, supra note 86, at 3 ("The basis for the court’s dismissal of ten of the cases is that the mortgage assignments were executed and recorded after the complaints in each case were filed.").

98. See Cadwalader Memo, supra note 86, at 3 ("In the five cases that were not
indicates that he was reacting to the audacity of the plaintiff’s attorney (and by implication the institutional lenders he represented) who were essentially asking the court to ignore the fact that DB did not keep accurate paperwork in order to speed up the foreclosure process. 99

In another foreclosure case decided in the Northern District of Ohio fifteen days later, Judge Rose ordered the plaintiff-lenders in twenty-seven cases to submit documentation within thirty days showing they had standing when the complaint was filed or he would dismiss their cases without prejudice. 100 Judge Rose spoke directly about the role that the plaintiffs’ noncompliance played in his decision, even reprimanding one plaintiff’s attorney for his conspiracy in the plaintiff’s failure to produce documentation of assignment. 101 Notably, neither Judge Rose’s opinion nor the other opinions from Ohio preclude plaintiff-lenders from re-filing with sufficient paperwork in situations where the court dismisses the complaints because it is perturbed by the plaintiff’s insolence, but does not doubt the plaintiff’s sincerity. 102 Therefore, plaintiffs can easily cure standing if the mortgage and note were in fact assigned in the first place. 103

dismissed, the mortgage assignments were executed and recorded before the complaints were filed.

99. See Boyko, 2007 WL 3232430, at *3 n.3 ("Plaintiff’s, ‘Judge, you just don’t understand how things work,’ argument reveals a condescending mindset and quasi-monopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process.”). Astoundingly, even the Restatement contemplates the failure to document transfers carefully, creating rules that give transferors and transferees little to no incentive to do so. See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4 cmt. a (1997) ("[E]xperience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section’s purpose is generally to achieve the same result even if one of the two aspects of the transfer is omitted.").

100. See In re Foreclosure Cases, 521 F. Supp. 2d 650, 654 (S.D. Ohio 2007) (ordering twenty-seven plaintiffs to submit evidence showing that they had standing and that the court had diversity jurisdiction or the court would dismiss their foreclosure cases).

101. See id. at 655 (stating that since the plaintiff’s attorney is well aware of the rule requiring documents showing the plaintiff owns the note and mortgage, "failure in the future by this attorney to comply with the filing requirements . . . may only be considered to be willful").

102. See id. at 654 ("[P]laintiffs are given until not later than thirty days following entry of this order to submit evidence showing that they had standing . . . Failure to do so will result in dismissal without prejudice to refiling . . ."); Boyko, 2007 WL 3232430, at *1 ("After considering the submissions, along with all the documents filed of record, the Court dismisses the captioned cases without prejudice."); O’Malley, No. 1:07cv1007, et al., 2007 WL 4034554, at *1 (Nov. 14, 2007) ("This case is DISMISSED without prejudice.").

2. Sanctions: When the Mortgage Assignment is Misrepresented to the Court

In furtherance of the Ohio federal courts’ actions to defend mortgagors in foreclosure proceedings, at least one bankruptcy court in Massachusetts has invoked its power under Rule 9011 of the Federal Rules of Bankruptcy Procedure 104 to sanction a plaintiff-lender where the court had evidence that the plaintiff-lender was not the holder of the note, but represented itself as the holder to the court. 105 In In re Nosek, 106 without even addressing whether it was the intent of the mortgagee and the plaintiff to assign the note and the mortgage to the plaintiff, the court fined plaintiff-lender Ameriquest under its Rule 9011 sanction powers, stating:107 "The argument that the assignment of the note and mortgage was a matter of public record and therefore the Debtor knew or should have known of Norwest’s identity [as the assignee of the note originated by Ameriquest] is relevant but disingenuous, indeed even arrogant."108 In In re Nosek, although the court admitted that it was imposing sanctions on the plaintiff as punishment for misrepresenting itself to the court, there was no evidence that Ameriquest

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104. See Fed. R. Bank. P. 9011(c) (establishing sanctions for violations of the rule that by presenting a document to the court an attorney is certifying that to the best of her knowledge, information, and belief it is not being presented for any improper purpose, and that the claims are warranted and have evidentiary support).

105. See In re Nosek, 386 B.R. 374, 378 (Bankr. D. Mass. 2008), vacated, 406 B.R. 434 (D. Mass. 2009) (explaining that Ameriquest was the loan originator, but not the note holder as of the date of the debtor’s bankruptcy petition). This information was not revealed to the Court until September 27, 2007 even though the debtor’s petition was filed on October 2, 2002. Id. at 377.

106. See id. at 385–86 (imposing sanctions on a loan originator, its attorneys, and the current holder of the loan for misrepresentations that were made in bankruptcy proceedings).

107. See id. at 383 ("This Court finds that Ameriquest made repeated misrepresentations and its behavior in failing to properly disclose its role was unreasonable under the circumstances. . . . Therefore Ameriquest is sanctioned $250,000.").

108. Id. at 382. Judge Rosenthal’s reasoning is lifted directly from the Restatement of Mortgages, which states, "The mere recordation of the mortgage assignment in the public records does not constitute notice to the mortgagor, since to so hold would in effect impose on mortgagors a duty to examine the record title to their land before making each payment—plainly an unreasonable burden." Restatement (Third) of Prop.: Mortgages § 5.5 cmt. c (1997). The lender’s argument that the mortgagor had notice was entirely irrelevant to Ameriquest’s main argument—that the attorneys should assume they are the holder in due course without proof. See In re Nosek, 386 B.R. at 382 ("The argument that . . . the Debtor knew or should have known of Norwest’s identity is relevant but . . . many of these same parties asserting this position allege they had no way of knowing about the assignment."). The bankruptcy court’s holding echoes Judge Boyko’s and further cuts against the Restatement.
had misrepresented itself to the debtor.\textsuperscript{109} Despite this fact, the court gave the debtor, rather than the lender and its successor-in-interest, the benefit of the doubt.\textsuperscript{110}

3. \textit{Tougher Solutions: When the Plaintiff is Not the Holder in Due Course}

Requiring plaintiffs to have standing matters because there is a real question as to whether assignees were bona fide purchasers of the mortgage,\textsuperscript{111} in addition to the problems that arise when the same mortgage is in two or three different pools.\textsuperscript{112} The industry has excused its lack of assignment paperwork as sloppy housekeeping,\textsuperscript{113} but sloppy housekeeping can no longer cover up the fact that the lack of documentation has become a constant business practice in the wake of securitized mortgages.\textsuperscript{114} Many

\begin{itemize}
\item \textsuperscript{109} \textit{See In re Nosek}, 386 B.R. at 382 (noting Ameriquest’s argument that proof of the debtor’s knowledge of the true identity of the mortgage holder was found in the debtor’s own schedules and matrix). Arguably, \textit{In re Nosek} is an extreme example because the lawsuit dragged on for five years, various law firms represented the plaintiff, and the defendant sought to join other plaintiffs who were similarly negligent in telling the court who held the note. \textit{Id.} at 377–80.

\item \textsuperscript{110} \textit{See id.} at 382 ("This Court will not countenance creditors and creditors’ attorneys holding themselves to a different and clearly lower standard than what they expect of the Debtor. . . . It is the creditor’s responsibility to keep a borrower and the Court informed as to who owns the note and mortgage . . . .").


\item \textsuperscript{112} \textit{See Gretchen Morgenson, Foreclosures Hit a Snag for Lenders, N.Y. TIMES, Nov. 15, 2007} (reporting the claim that in several instances mortgage experts have observed the same loan in several different mortgage pools).

\item \textsuperscript{113} \textit{Cf. Boyko, No. 1:07cv2282, et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007)} (criticizing plaintiff-lender’s argument that Judge Boyko does not understand how things work in the mortgage-lending industry and therefore he should excuse its lack of documentation); Ivry, \textit{supra} note 111 (explaining that banks are used to using the excuse that they lost the note and the court pushing the foreclosure through anyway); Mike Stuckey, ‘\textit{Angel}’ of Foreclosure Defense Bedevils Lenders, MSBN\textsc{c}.\textsc{com}, Dec. 19, 2008, available at \url{http://www.msnbc.msn.com/id/28277420/} (last visited Oct. 19, 2009) (quoting one attorney describing the sloppiness, fraud and outright criminality she sees in the mortgage lending industry) (on file with Washington and Lee Journal of Civil Rights and Social Justice).

\item \textsuperscript{114} \textit{See Ivry,} \textit{supra} note 111 (describing the pattern and practice of mortgage servicers and securitizing banks of filing a "lost-note affidavit" when they fail to present proof to the court that they own a mortgage). Lost-note affidavits are the rule in the industry rather than the exception. \textit{Id.}
courts, even those outside of Ohio, have taken note and no longer accept the "take my word for it" defense to standing requirements.115

Even more troubling is that the lack of recorded assignments of mortgages may not be attributable to sloppy housekeeping at all. April Charney,117 a leading defense attorney in foreclosure proceedings in Florida, has argued that in many instances the original mortgages were assigned without the notes in violation of true sale obligations under securities law.118 This could explain the trustees’ widespread lack of documentation.120 Moreover, it reinforces the need for courts to enforce standing requirements to defeat the outdated presumption that the assignment of the note was transferred with the mortgage absent intent to the contrary.

In conclusion, courts need to take a more active role in protecting the homeowner from willful noncompliance by trustees of securitized mortgages. This may require imposing sanctions on attorneys where, as in Noset, noncompliance arguably masks the fact that the plaintiff is not the holder in due course. Fortunately, the sua sponte imposition of standing may curb the willful failure problem, as plaintiffs can no longer rely on

115. Id.

116. See, e.g., id. (discussing that California Bankruptcy Judge Samuel L. Bufford requires plaintiff-lenders to bring the mortgage notes to court because problems underlying mortgage securitization has caused him to doubt that promissory notes are sufficient to show that plaintiff has a right to enforce that note); see also Gretchen Morgenson, Guess What Got Lost in the Loan Pool?, N.Y. TIMES, March 1, 2009, at BU1 (discussing judges in other states who are requiring formal proof of assignment).

117. April Charney is an attorney with Jacksonville, Florida Legal Aid. For more information about April Charney and her work representing homeowners facing foreclosure see Stuckey, supra note 113.

118. See Vinodkothari.com, The True Sale Question, http://www.vinodkothari.com/truesale.htm (last visited Sept. 16, 2009) (explaining that true sale rules protect investors by giving them an unqualified right over the assets being securitized) (on file with Washington and Lee University Journal of Civil Rights and Social Justice). If true sale requirements are not met, then the investors are unsecured lenders and do not have a priority right to receivables. Id.

119. See Stuckey, supra note 113 (“‘What we see is that systematically, the originating lenders only pledged these loans and didn’t actually transfer them’ to the trusts that are supposed to hold them and issue the securities . . . ”).

120. But see Cadwalader Memo, supra note 86, at 4 (evidencing the belief that the trustees were acting in good faith and merely could not find the paperwork due to logistical reasons). "While this may cause certain logistical issues for the trustees and servicers of the defaulted mortgage loans, we do not believe that the decision itself has any broader legal significance." Id. For another source attributing the trustee’s lack of paperwork to oversight see Ivry, supra note 111 (quoting an attorney who also blames the lack of paperwork on logistical reasons).
courts to rubber stamp their foreclosure proceedings. Another solution is for courts to go a step further and dismiss cases with prejudice when the court decides that plaintiff-lenders will never be able to present documents sufficient to show assignment or ownership before the date the complaint was filed because they do not exist.

a. Standing Will Incentivize Loan Renegotiation

At first glance, standing is not a permanent solution because it does not address the underlying issue. The standing defense doesn’t void the mortgage. Nor is its success likely to result in dismissal with prejudice. Defending a foreclosure proceeding takes both time and money. Even if a homeowner can afford a defense attorney and is able to prevail, she might prefer to avoid litigation entirely. Finally, as has already been mentioned, there is no bar preventing plaintiff-lenders from refiling.

However, one positive aspect of the standing defense is that by making it more costly for trustees to instigate foreclosure proceedings, mortgagors will have leverage to renegotiate the terms of the underlying loan. If

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121. See Midfirst Bank v. Davenport, No. 3:07-CV-405, 2007 WL 4246271, at *1 (S.D. Ohio Nov. 29, 2007) ("Because standing involves the federal court’s subject matter jurisdiction, it can be raised sua sponte.").

122. Cf. O’Malley, No. 1:07cv1007, et al., 2007 WL 4034554, at *1 (Nov. 14, 2007) (dismissing the foreclosure actions without prejudice because the foreclosure plaintiff did not provide documentation that it was the owner and holder of the note and mortgage at the time the foreclosure action was filed).

123. See Stuckey, supra note 113 ("Making an issue out of the actual ownership of the securitized title might strike some as a shameless stalling tactic aimed at abetting a debtor who, after all, owes the money."). Nor is it always an available defense. See New York v. Stuart, No. 06CA008953, 2007 WL 936706, at *2–3 (Ohio App. 9 Dist. March 30, 2007) (finding that the plaintiff-lender had standing to bring a foreclosure action against the defendant even though the assignment of the note did not take effect until after the complaint was filed); see also Stuckey, supra note 113 (noting that the standing defense is one among many that attorneys utilize to assist homeowners facing foreclosure).

124. See In re Williams, 395 B.R. 33, 42 (Bankr. S.D. Ohio 2008) ("The Trustee's position is that the failure to record an assignment of a mortgage in Ohio allows the Trustee as a bona fide purchaser to void the mortgage lien held by the assignee of the mortgage. The court does not agree.").


126. See, e.g., In re Williams, 395 B.R. at 49 (dismissing plaintiff’s suit without prejudice).

127. See Stuckey, supra note 113 (discussing attorney April Charney’s strategy of settling cases by using the flaws she exposes in debt ownership and loan servicing to
courts across the country were to enforce standing requirements on plaintiffs who hold securitized mortgages in trust, then the transaction costs of foreclosure proceedings may dissuade trustees from filing when they do not have their paperwork ready.128 Alternatively, in cases where "sufficient documentation" does not exist, the widespread imposition of standing requirements may encourage trustees to look favorably on loan renegotiation.129

In sum, when the plaintiff-lender is not actually the holder in due course, the standing defense restores justice to foreclosure proceedings so long as the court holds the plaintiff to the formal standards set out by Judge Boyko in Ohio. When the plaintiff-lender is the holder in due course but has for logistical reasons misplaced original documents showing that the entire obligation was assigned to the plaintiff prior to filing the complaint, the standing defense works, but only as a temporary warning to the mortgage industry participants about the formality involved in real property proceedings.130 It is important that courts recognize when they are confronted with each scenario. The upside to a case-by-case approach is that some of the costs of securitization, which were never internalized, can finally be assigned to the parties responsible for its high costs.

IV. Legislative Solutions

Outside of litigation, mortgagors facing default may have the option to renegotiate their mortgage loans. Many nontraditional mortgages131 are

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128. See id. (discussing that once the loan servicer cannot profit from a foreclosure proceeding, it lies dormant); Morgenson, supra note 112 ("The people who put the deals together get paid for the deals, but they don’t get paid for the paperwork."). For a discussion of the costs associated with maintaining the paperwork underlying securitized mortgages, see Ivry, supra note 111 (citing a figure of $45,000 a month to store loan paperwork).

129. However, critics of the standing defense argue that there is no incentive for lenders to settle once they know they will not make a further profit from the mortgage.

130. Whether or not the plaintiff is a holder in due course shown by the intent of the parties at the time of assignment or the plaintiff has been assigned the mortgage only in violation of true sale requirements is irrelevant to the repercussion: Neither plaintiff will be able to bring foreclosure without proper documentation.

131. This discussion of mortgagors who want to renegotiate the terms of their mortgages is not limited to subprime borrowers. It has become increasingly problematic for borrowers with Alt-A mortgages and even prime nontraditional mortgages to repay their mortgages once the mortgages have been reset. See Bair Testimony, supra note 2, at 729 (noting the upcoming resets of Alt-A and prime nontraditional mortgages).
adjustable rate loans which are subject to payment resets, meaning the interest rate spikes after two or three years at the starter rate. After the interest rate increase, monthly payments increase, and many homeowners are no longer able to make their monthly payments. Homeowners who were faced with the same situation in the past could refinance their mortgage. However, the decrease in home values and the tightening of the credit market have reduced the availability of refinancing options for homeowners.

The advantage of renegotiating the terms of the loan is that it can avoid default scenarios altogether. Since foreclosures reduce the value of homes in entire neighborhoods, preventing default will have a three-fold effect on homeowners: it will keep homeowners who can pay a more reasonable monthly mortgage in their homes; it will help maintain home values of houses in entire neighborhoods; and it will protect neighbors who are not in default from defaulting on loans that greatly exceed the current value of their homes. Preventing foreclosure will also benefit the trustees of securitized debt instruments. MBSs held by trustees will have some of their original value restored and trustees will be saved the costs of instigating foreclosure proceedings when the benefit of receiving reduced payments would outweigh the cost of litigation.

132. For example, a 3-year subprime hybrid ARM taken out in 2003 could have an interest rate of 7% until 2006 and then could spike to 10% after the reset depending on the level of market interest rates. See id. at 730 (describing a typical subprime loan as providing a starter rate between 7 and 9% but increasing as much as 3% within the first year after reset).

133. See id (characterizing the increased monthly payments as a steep "payment shock" for borrowers). Furthermore, many such nontraditional mortgages subject borrowers to prepayment penalties if they were to repay the loan while the starter rate applied. Id.

134. See id. ("In today’s . . . challenging environment, payment reset will lead less often to refinancing and more often to default and foreclosure.").

135. See id. at 729 (proposing that loan modifications provide the best way to avoid foreclosures and provide for long-term solutions).

136. See id. at 732 (noting that modifying loans before resets would permit borrowers to stay in their homes, preserve neighborhoods, and provide investors with great returns than they would receive from foreclosures).

137. See id. at 734 ("Permitting borrowers with an ability to make reasonable payments to stay in their home would provide greater value to lenders and investors than forcing foreclosures . . . ").
A. Loan Servicers Can Renegotiate Loans by Contract Right

The first problem that arises when a loan is renegotiated is whether loan servicers, who collect payments from homeowners to give to trustees to hold for the bondholders, have the power to renegotiate loans with individual homeowners. Arguably, they do despite the fact that securitization complicates the issue. MBSs are governed by contractual arrangements known as pooling and servicing agreements (PSAs) entered into by all parties to the transaction, including loan servicers and bondholders. By contract, loan servicers are required to protect the interests of bondholders and conduct a net present value (NPV) analysis when determining the appropriate loss mitigation strategy in a default scenario. As the American Securitization Forum has pointed out, loan servicers should be bound to the interests of the bondholders. However, because bondholders are divided into different tranches with potentially dissimilar interests, servicers cannot always tell what actions will be in bondholder’s best interests. But nothing in a typical PSA prevents loan

138. See id. at 731 ("While initially there was concern that securitization... might place limits on the ability of servicers to modify loans in the securitization pool, most documents provide the servicers with sufficient flexibility to modify loans.").


140. See Bair Testimony, supra note 2, at 731 ("While the language varies, the majority of PSAs require that servicers: (1) protect the interests of investors, and (2) conduct a net present value (NPV) analysis when determining the appropriate loss mitigation strategy in a default scenario."). For more information about methods of determining loss mitigation, see Foreclosure Prevention: The Importance of Loss Mitigation Strategies in Keeping Families in Their Homes: Field Hearing Before the H.R. Subcomm. on Housing and Community Opportunity, 110th Cong. 17 (2007) (statement of Tara Twomey, Of Counsel, National Consumer Law Center).

141. See American Securitization Forum, Statement of Principles, Recommendations and Guidelines for the Modification of Securitized Subprime Residential Mortgage Loans, 4 (June 2007), http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf ("Generally, the ASF believes that loan modifications should only be made...[i]n a manner that is in the best interests of the borrower... ").

142. See Golden & Fazili, supra note 139, at 39 ("[I]nvestors themselves are different classes with competing interests, and thus cannot speak in one unified voice to direct the servicers."). See also Eggert, infra note 145, at 279 (defining "tranche warfare" as the divergence of bondholders’ interests). Furthermore, sometimes it would be impossible for bondholders to share a common "best interest" at all.
servicers from renegotiating loans with individual homeowners in situations where the NPV of modification exceeds that of allowing a loan to go into foreclosure.  

B. Who Should Facilitate Loan Renegotiation?

The second problem that arises when a loan is renegotiated is deciding who should facilitate loan renegotiation: private actors, state actors, or federal actors. By examining all three briefly, it will become apparent that federal action is necessary for two reasons: First, because federal law preempts most state usury laws, state laws are not efficient regulators, and second, financial institutions do not have an honest track record of self-regulation and are unlikely to voluntarily renegotiate loans themselves even if it is in their best interest.  

1. Private Loan Modification is Idealistic

The Federal Deposit Insurance Corporation (FDIC) recently advocated a systematic and voluntary private loan modification program for subprime Adjustable Rate Mortgage (ARM) loans for owner-occupied properties where borrowers are current on their payments but will not be able to make the payments after the interest rates are reset. Sheila Bair, Chairman of the FDIC, unveiled the plan that recommends servicers modify loans so that borrowers pay the same amount of interest that they paid under the starter rate even after the loans are reset.

143. See Eggert, infra note 145, at 287 ("PSAs often grant the servicer a certain amount of discretion in modifying loans . . . .").

144. See infra note 162 (citing how financial actors have used federal preemption laws to bully states).

145. See Bair Testimony, supra note 2, at 731 (arguing that because servicers are bound to the interests of bondholders in the aggregate and because renegotiating loans will often be less expensive than foreclosing that trustees should be incentivized to modify loans and keep borrowers in their houses). But see Kurt Eggert, Comment on Michael A. Stegman et al.’s "Preventing Servicing is Good for Business and Affordable Homeownership Policy: "What Prevents Loan Modifications?", 18 HousinG Pol’y Debate 279, 290 (2007) (listing the disincentives servicers have to modify loans, such as the fact that late charges comprise a substantial portion of their income).

146. See Bair Testimony, supra note 2, at 731 (recommending that servicers modify loans of homeowners who have remained current on their payments but may not remain current when the rate resets).

147. See id. (advising that servicers modify loans to keep the starter rate for a period of
The advantages of Bair’s plan are apparent. It can be implemented immediately, it is inexpensive, and it is voluntary. Private loan modification can be instigated as soon as possible because it does not require federal legislation, and a systematic approach is faster than a loan-by-loan approach.148 Bair’s plan does not require federal spending.149 And finally, because it is voluntary, the policy does not affect the legal rights of bondholders by modifying their contractual rights and subjecting servicers to liability.150

But its disadvantages are also apparent. There is no time frame requiring servicers to modify loans immediately. Asking an entire industry to change its practice will take time even if all the servicers agree to implement the policy.151 Additionally, there is no monetary incentive to make servicers reach out to borrowers.152 Because voluntary modification is a preventative remedy, if loan servicers do not initiate loan modifications soon, homeowners will not receive the potential benefits before their interest rates reset and they default.153 Furthermore, there is no reward (or punishment) for servicers who modify (or fail to modify) loans voluntarily.154 A fuzzy duty not to harm bondholders will not incentivize loan servicers even after this duty is made known to them.155 Arguably, preventing more foreclosures is too important to wait for an industry to incentivize itself. In sum, the plan is overly idealistic because it relies on five years or more).

148. See id. ("A streamlined approach can be undertaken much more rapidly than a loan-by-loan restructuring process.").

149. See id. ("[T]his approach does not involve a bailout involving federal tax dollars.").

150. See id. ("[T]his policy does not involve government action that would affect the contractual rights of mortgage investors because it is based on voluntary action by the servicers.").

151. For example, as a threshold matter, servicers must adopt guidelines they will use to determine whether a borrower will not be able to pay her mortgage after the reset period. See Bair Testimony, supra note 2, at 732 (citing as a substantial accomplishment the set of guidelines that the American Securitization Forum and the Hope Now Alliance developed to be adopted as the standard practices for loan modifications).

152. See id. (pointing to advantages of the systemic loan modification approach, none of which are monetary incentives).

153. See id. ("[N]ow is the time to show progress. Servicers must demonstrate an aggressive effort to dramatically increase the pace of loan modifications.").

154. See id. (encouraging servicers, by appealing to practicality, to adopt a systemic approach to loan modifications).

155. See infra notes 164–165 (discussing servicers’ fiduciary duty to bondholders); see also Eggert, supra note 145 and accompanying text (listing disincentives to modify loans).
loan servicers to act in the long-term best interests of bondholders rather than in their own immediate self-interest.156

Another drawback to FDIC’s plan is that it is narrowly tailored to work for loans that subject mortgagors to interest rate resets, but does not address nontraditional mortgages that pose different problems for borrowers.157 Borrowers with Alt-A or nontraditional prime mortgages may require more lenient loan renegotiations as homeowners find themselves paying loans on houses which are not worth as much as they owe.158 When a homeowner owes more on her house than it is worth, the problem facing loan servicers is a lack of guidance, not a lack of incentive.159 In these cases, where the problems facing homeowners are more individualized, it is too much to ask servicers to voluntarily renegotiate loans on an individual basis without clear guidelines because this could change the attributes of the loan and affect the rights of bondholders.160

2. State Laws Are Preempted

State actors were the first parties to be proactive and try to remedy the mortgage foreclosure crisis because they were the first to observe its negative local effects.161 However, many states, especially smaller ones, were met with resistance by financial actors who denied that the state had authority or jurisdiction over them citing federal preemption laws.162 The

156. To reiterate, this argument assumes that what is in the best interests of bondholders (1) exists and (2) can be ascertained. See supra note 142 and accompanying text (describing the difficulty of determining bondholders’ best interests).

157. See Bair Testimony, supra note 2, at 734 (recommending that services apply the same systematic approaches to restructuring nontraditional loans as they do to subprime hybrid ARMs).

158. See id. ("Some borrowers pose even more difficult issues because their debt far exceeds the value of their homes.").

159. See id. (explaining that the loan servicers are incentivized to renegotiate the loans to prevent the mortgagor from walking away from her property without losing money).

160. See id. at 734 (stating that servicers should decide whether writedowns of the balance to match the value of the home or forgiveness of arrearages of principal and interest will be a better option than foreclosure or short sale).


162. Golden & Fazili, supra note 139, at 41 ("[S]ome governmental actors found themselves increasingly limited by the rising power of federal preemption in the financial
federal government’s increasing preemption of state usury laws has led to
the current status: Strong state consumer protection laws are preempted by
weak federal regulations.163

3. Federal Laws Can Incentivize Servicers to Modify Loans

a. A Statutory Fiduciary Duty to Bondholders

One solution that could incentivize servicers to modify loans is to
codify an affirmative fiduciary duty that servicers owe to bondholders, so
long as the law does not modify investors’ existing contractual rights.164
This would provide servicers with enough legal certainty to allow them to
proceed with a private loan modification program such as the FDIC’s
plan.165 However, a statutory fiduciary duty will only incentivize servicers
to modify loans when it is unquestionably in the bondholders’ best
interests.166

b. Revive the Home Owners’ Loan Corporation

Another possible solution is for the federal government to pass
legislation that is based on the principles that fueled the Home Owners’
Loan Corporation (HOLC), a federal agency established in 1933 by the
Home Owner’s Loan Act.167 The HOLC gave relief to homeowners who
were in or near default by buying their mortgages from banks (in return for

163. See id. at 67 ("While robbing the states of many tools they once used to protect
consumers, the federal government has not simultaneously stepped in to offer its own
comprehensive set of consumer protections to replace state protections.").

164. Bair Testimony, supra note 2 at 733. For an analysis of how a fiduciary duty
could arise between servicer and mortgagor through the courts, see Nathan Hanning, Waking
from the American Dream: Expanding Fiduciary Duties to Secondary Lenders Following

165. See Bair Testimony, supra note 2, at 733. (discussing that one of the reasons that
servicers cite to explain the slow pace of loan modification is concern about their legal
liability to investors).

166. For a discussion of why loan servicers might prefer foreclosure proceedings to
loan renegotiations, see Eggert, supra note 145 and accompanying text. For a discussion of
why bondholders will rarely agree, see the discussion of tranche warfare. Id. at 279.

167. See Alan S. Blinder, From the New Deal, a Way Out of a Mess, N.Y. TIMES, Feb.
24, 2008, at 6 (describing the history of HOLC).
government bonds) and issuing mortgages with more affordable terms to homeowners. 168 Essentially, the government created the credit needed to provide homeowners with the opportunity to refinance their loans. 169

A similar program that affords homeowners the opportunity to refinance their loans at lower interest rates would mean homeowners do not have to rely on servicers (who are hesitant to risk legal liability) to modify loans. The entire incentive problem would melt away because individual borrowers would be deciding for themselves whether to refinance. 170 Although this remedy is fraught with the problems that characterize most political decisions, it has the potential to absorb the costs of securitization. 171 As a result it is the least expensive and most direct remedy that is practicable. 172 And most notably, it is a permanent solution.

V. Conclusion

One of the fundamental problems of the mortgage foreclosure crisis is answering the question: Who should pay for the costs of securitization? 173 Both of the solutions discussed in this Note directly address this problem. The standing defense shifts the burden onto the party claiming the right to foreclose to prove it is the holder in due course and entitled to the remedy

168. Id.
169. Id.
171. See Blinder, supra note 167 (arguing that it may even make money: "Given current low interest rates, a new HOLC could borrow cheaply and should find it easy to earn a two-percentage point spread between borrowing and lending rates, for a gross profit of maybe $4 billion to $8 billion a year").
172. While the FDIC voluntary renegotiation plan as proposed will not cost the federal government any money, critics have pointed out that without a direct monetary incentive to servicers it is unlikely to succeed. See PICO AND CENTER FOR RESPONSIBLE LENDING, COMMON-SENSE SOLUTIONS FOR SAVING HOMES AND COMMUNITIES (2009), http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/common-sense-solutions-for-saving-homes-and-communities.pdf (arguing that voluntary loan modification programs are not stemming the tide of foreclosures). The factsheet points to four obstacles in the way of voluntary loan modification: (1) fear of investor lawsuits, (2) lack of servicer incentives, (3) second liens on houses, and (4) limited servicer and staff technology. Id.
of foreclosure. Shifting the burden onto trustees’ shoulders defrays the
costs of securitization onto trustees. While this solution is retroactive and
formalistic (it fails to penalize the loan originators, the investment bankers
who pooled the mortgages, and the investors who gobbled them up), it
solves one problem: That mortgagors should not pay for the transaction
costs created by securitization, a process that took place after their loans
originated and without their consent.

On the other hand, loan renegotiation reasons that all parties to the
loan were complicit in the process of securitization, and all parties should
share equally in its costs. In the long run, all parties benefit from loan
renegotiation—homeowners prevent default and stay in their homes and the
stream of payments that reaches bondholders is greater than what they
would have received had the houses been sold in foreclosure proceedings.
The immediate problems, though, are incentivizing loan servicers to enter
into renegotiation and insulating loan servicers from suit. This can best be
done with federal legislation requiring servicers to act and predetermining
the legal duty they owe to bondholders.

In conclusion, a federal law calling for proactive loan renegotiation in
conjunction with formal standing requirements has the potential to be a
permanent, narrowly tailored solution to stem the eight million foreclosures
predicted in the next four years.174

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174. Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Foreclosure
Update: Over 8 Million Foreclosures Expected, Credit Suisse (Dec. 4, 2008), cited in
Center for Responsible Lending, Nevada Foreclosures: Impact and Opportunity