Mortgage Repurchase and Make-Whole Defense: The Latest Strategies and Tips to Resolve Repurchase Claims

Presented by:

James Brody, Esq.
American Mortgage Law Group, P.C.
75 Rowland Way, Ste. 350, Novato, CA 94945
Telephone: (415) 878-0030
Email: JBrody@americanmlg.com
Info@americanmlg.com

Rob Zimmer
Community Mortgage Lenders of America, Inc.

Ken Ferrari
Director of Business Development
Community Mortgage Lenders of America, Inc.
Telephone: 888.945.9488
Email: kferrari@thecmla.com
Brief Introduction to
American Mortgage Law Group, P.C.

- AMLG is a mortgage law practice located in Novato, CA.
- We focus on:
  - Repurchase Litigation
  - Contract Disputes
  - Repurchase Mitigation/Rebuttal Defense
  - Fraud Resolution/Recovery
  - Third Party Recovery Analysis
  - Forensic File Review
  - Investigative and Asset Search Services
  - Title Clearance and Title Claims
  - State and Federal Regulatory Compliance Issues
- And much, much more!
Mortgage Repurchase and Make-Whole Defense

Introduction

- Unreasonable and often unwarranted repurchase demands have plagued lenders and originators for years.

- The various strategies to defend against and rebut these repurchase claims is constantly changing and evolving in light of new regulations/guidelines and relevant court decisions.

- This webinar will discuss the most up-to-date repurchase and make-whole defense strategies and issues.
Overview

I. Part I: Legal Defenses to Repurchase Claims
   • Detailed Examination of Various Legal Defenses Available to Lenders.

II. Part II: Rebuttal Strategies
    • Specific Strategies to Rebut Common Repurchase Allegations.

III. Part III: The Effect of Industry Settlement Agreements
     • Overview of Major Settlement Agreements Between Secondary Market Investors and Agencies.

IV. Part VI: Current Litigation Landscape
    • Current Litigation Landscape with Major Institutional Investors.
    • Latest Repurchase Litigation Defense and Resolution Strategies.
    • Settlement Strategies to Obtain Mutually Acceptable Resolutions.

V. Part V: FHFA New Representation and Warranties Framework
    • Discussion of FHFA’s New Representation and Warranties Framework.

VI. Part VI: Concluding Thoughts
    • Final Thoughts and Tips on Repurchase Defense.

These issues will be discussed – and your questions answered – by James Brody.
Part I:
Legal Defenses to Repurchase Demands

Aside from factual rebuttals, there are numerous legal arguments that can be made regardless of the accuracy of the repurchase allegation.
Challenge a Repurchase Demand Based on Rescission of Mortgage Insurance

- Investors have long pushed back loans to its correspondents based upon mortgage insurance rescissions.
- Make sure you have standing to deal with the MI companies directly. This often requires you to obtain a written consent from your Investor.
- Correspondents may fight back on various bases including:
  1. The fact that the MI company “contract underwrote” the file and is now rescinding MI due to its own negligence;
  2. The MI company’s allegations, even if true, are immaterial and/or do not increase the risk of the hazard insured;
  3. The “incontestability clause” that prohibits rescission for third-party misrepresentations, and for other reasons;
  4. Fight back these MI rescissions through Insurance Commissioner, if possible;
  5. Investors often push correspondents to repurchase loans for similarly dubious MI rescissions. It is imperative to appeal these MI rescissions.
Challenge a Repurchase Demand Based on Materiality

- Many loan purchase agreements base repurchase obligations on *material* violations of the representations and warranties.
- Things to consider when challenging the materiality of an allegation:
  1. Were there any compensating factors, such as potential rent for an undisclosed mortgage?
  2. Did the allegation increase the risk of the transaction?
  3. How many payments were made on the loan?
  4. Was the subsequent default the result of unforeseen circumstances, i.e. loss of job?
Challenge a Repurchase Demand Based on the Full Credit Bid Rule

- Did the Investor and/or FNMA purchase the property at a foreclosure sale via a credit bid?
- Some courts have held that a full credit bid at foreclosure extinguishes the associated mortgage. This is known as the Full Credit Bid Rule.
- Specifically, courts in favor of the Full Credit Bid Rule have reasoned:
  - A Lender and/or servicer making a credit bid at a foreclosure sale is acting in its capacity as a purchaser and is not required to bid the full amount of the loan.
  - Further, the amount bid at a foreclosure sale sets the value of the property acquired. Therefore, when a property is purchased at a foreclosure sale for the amount due on the mortgage, the debt is satisfied and the mortgage is extinguished.
  - When a Lender bids for the amount due on the mortgage at a foreclosure sale, it is not required to pay cash, but rather is permitted to make a credit bid because any cash tendered would be returned to it. This is known as a “Full Credit Bid.”
  - However, whether or not the Full Credit Bid Rule applies depends on the choice-of-law of the LPA and/or the state of the subject property.
Challenge a Repurchase Demand Based on Loss Mitigation

• Did the Investor and/or Agency effectively mitigate its damages with respect to the subject loan?
• Things to consider when challenging an Investor’s loss mitigation:
  1. Review the servicing history for instances of negligence.
  2. Was the subject property liquidated at market value?
  3. Request a detailed breakdown of all alleged damages.
  4. Were mortgage insurance proceeds deducted from any claimed damages?
  5. Was there an unreasonable lapse in time between foreclosure and REO sale?
Challenge a Repurchase Demand Based on the Statute of Limitations

• There are inconsistent rulings regarding whether the statute of limitations ("SOL") begins to run on the date of the first alleged breach, i.e. - when loan documents with misstatements are transferred to the Investor; or when a lender refuses to comply with the demand.

• Things to consider when challenging a demand based on the SOL:
  1. What state law governs the loan purchase agreement with the Investor? What is the applicable SOL for breach of contract claims in that state? Are there any court decisions in that state clarifying when the SOL claim begins to run?
  2. How many years have lapsed since origination?
  3. How many years have lapsed since demand was first made?
Statute of Limitations for Specific Investor Loan Purchase Agreements

- Lehman Brothers Holdings, Inc. – 6 years (N.Y. C.P.L.R. § 213 (McKinney)).
- GMAC/Ally Bank – 6 years (Minn. Stat. § 541.05, subd. 1(1)).
- Chase - 6 years (N.J. Stat. Ann. § 2A: 14-1; N.Y. C.P.L.R. § 213 (McKinney)).
- CitiMortgage – 10 years for contract dispute over payment of money (Mo. Ann. Stat. § 516.110; see also Hughes Dev. Co. v. Omega Realty Co., 951 S.W.2d 615, 617 (Mo. 1997)); 5 years for all actions upon contracts, obligations or liabilities (Mo. Ann. Stat. § 516.120).
- Wells Fargo – 6 years (Minn. Stat. § 541.05, subd. 1(1)).
- FlagStar – 6 years (Mich. Comp. Laws Ann. § 600.5807(8)).
The Statute of Limitations Debate

• Investors and Lenders are at odds regarding when the SOL begins to accrue for breach of contract claims in repurchase litigation.
• Specifically, Investors often argue that the SOL does not begin to run until they actually incur damages as a result of the breach, i.e. when the Investor indemnifies Fannie Mae/Freddie Mac. Investors also argue that the failure to repurchase upon demand is a separate breach of the associated loan purchase agreement (“LPA”).
• Lenders, on the other hand, often assert that the SOL begins to run at the date of sale because the representations and warranties with respect to any loan are made as of the date of sale – per the LPA. As such, any breach thereof would occur on the date of sale. Further, Lenders argue that the repurchase obligation in the LPA is merely a remedy and therefore, the failure to repurchase does not constitute a separate breach of contract claim for purposes of the SOL.
• However, courts have been inconsistent in their decisions regarding when the SOL begins to run for repurchase claims.
Important New York SOL Decisions

• Certain courts applying NY state law have found that repurchase and indemnification obligations are actually remedies, therefore the breach commences on the date that the loan documents are transferred.

• Specifically, the First Department of the New York State Supreme Court, Appellate Division recently held that a $330 million mortgage securities lawsuits brought against a unit of Deutsche Bank AG was barred under New York’s six-year SOL, ruling that the SOL began to run at the date the loan was sold under the contract because “any breach of the representations and warranties contained therein occurred” on such date. See ACE Securities Corp v. DB Structured Products Inc., -- N.Y.S. 2d ---, 2013 N.Y. Slip Op. 08517.
  – The decision overturned a May 13, 2013 ruling which had held that the SOL did not begin to run until the bank refused its investor’s repurchase demands.

• This ruling is significant in that it directly supports the argument that many suits brought stemming from loans originated during the financial crisis are untimely and reverses a decision which investors have relied on heavily since its entry in May 2013.
  – See also LBHI v. Evergreen, 793 F. Supp. 2d 1189 (2011), holding that the SOL for repurchase claims commenced on the date upon which the Investor could have initially demanded payment for the alleged misrepresentations – i.e., the date Investor purchased the loan from the originator.
  – See also, Hahn Automotive Warehouse, Inc. v. Am. Zurich Ins. Co., 81 A.D.3d 1331, 916 N.Y.S.2d 678, 680 (2011), holding that “[a] cause of action for breach of contract accrues when the party making the claim possesses a legal right to demand payment...To find otherwise would allow an Investor to circumvent the statute of limitations by deferring its demand.”
  – See also, Nomura Asset Acceptance Corp. Alternative Loan Trust, Series 2005-S4 ex rel. HSBC Bank USA, Nat. Ass'n v. Nomura Credit & Capital, Inc., 39 Misc. 3d 1226(A) (N.Y. Sup. Ct. 2013), holding “[t]he repurchase obligation in this case is merely a remedy. It is not a duty independent of the Mortgage Representation breach of contract claims. The statute of limitations runs from the time of breach of the Mortgage Representations, not from the time plaintiff elected to make demands for repurchase.”
The Potential Impact of ACE Sec. v. DB Structured Prod.

- The ACE Sec. ruling will be helpful but not dispositive for all repurchase claims. Specifically, the decision will only be controlling in cases where the underlying agreement is governed by NY law.
  - However, the case may nonetheless be used as persuasive authority for cases that involve agreements governed by the laws of other states.
- Further, the ACE Sec. decision will likely be appealed.
- However, if the decision is upheld, the SOL defense could drastically reduce the amount of repurchase claims filed in connection with agreements governed by NY law and dramatically improve the lenders' and/or originators' ability to defend against repurchase demands involving loans originated over six years ago.
- Until such confirmation, however, Investors will likely continue to rely on conflicting cases such as, Lehman Bros. Holdings, Inc. v. Nat’l Bank of Arkansas, 875 F.Supp.2d 911, 917 (E.D. Ark. 2012), which supports the position that a separate breach occurs when the originator fails to repurchase a loan, as required by contract.
Part II: Rebuttal Strategies

Specific strategies and tips to rebut common repurchase allegations.
Strategies for Rebutting an Unsupported Appraisal Allegation

- Unsupported appraisal is a very common repurchase allegation.
- FNMA in particular issues a lot of repurchase demands based on the unsupported appraisals and is notoriously unreasonable with respect to its allegations.
  - Specifically, FNMA often holds the Lenders (through the origination appraisal) to a higher standard than FNMA does itself with respect to the FNMA review appraisals. FNMA will assert that the origination appraisals must be in perfect compliance with all of the relevant USPAP and FNMA Guidelines, while the FNMA review appraisals often contain blatant errors - such as inappropriate comparables and unadjusted, unanalyzed MLS sheets.

- Things to consider when fighting back an allegation of unsupported appraisal:
  1. Order a retrospective review appraisal through your in-house or outside counsel;
  2. Analyze the appraiser’s scope of work, the comparable selections (facts v. opinion);
  3. Also consider putting the original appraiser and his/her E&O carrier on notice.
Strategies for Rebutting an Undisclosed Liability Allegation

- Recalculate the DTI to determine whether the alleged undisclosed debt would increase the DTI by more than the allowed 2% variance.
- Review the guidelines to confirm whether or not the revised DTI exceeded the maximum allowed under the applicable guidelines.
- Were there any compensating factors that would offset the payment, such as potential rent for undisclosed mortgage?
- Confirm that the undisclosed debt actually existed prior to closing of the subject transaction. Specific Example:
  - **Issue**: Two undisclosed student loans with a combined monthly payment of $214 yielded excessive DTI and rendered the origination DU approval invalid.
  - **Rebuttal**: One of the two loans was closed after the subject transaction, and the another loan was disclosed on the 1003 and accounted for in qualifying.
Strategies for Rebutting an Income Misrepresentation Allegation

- Request all supportive documentation referenced by the Investor in the repurchase demand.

- Review the LPA for any discussion of “knowledge” or “awareness” with respect to the representations and warranties and repurchase obligations.

- Was the loan product a stated income loan product or full doc?
  - Challenge the allegation based on whether or not the borrower’s income was “reasonable” rather than “accurate.”

- Specific Example:
  - Issue: The stated income was unreasonable as the borrower just moved to Colorado three months prior to the loan origination.
  - Rebuttal: The borrower had been working as a chiropractic physician and an expert witness for twenty years. His practice was upon a national reputation, which was not geographically restricted.
Strategies for Rebutting a Guideline Violation Allegation

• Facts, facts, facts: Review the specific facts of the underlying allegation in conjunction with the applicable underwriting guidelines.

• Request that the Investor provide you with the exact Sellers’ Guide that was in place at the origination of the subject loan, including any and all associated policies, release notes, bulletins, revisions, amendments, clarifications, corrections, updates, newsletters, memos or training manuals/presentations provided directly to the Lender or the lending industry in general.
Strategies for Rebutting a Missing Documentation Allegation

- Review the loan file to determine whether or not the document was in fact omitted from the loan file.

- Request that the Investor provide a detailed checklist of everything included in the loan file at the original sale.

- Reach out to the borrower for missing documentation, such as bank statements, W-2’s, gift letters, etc.
  1. Did the borrower sign an Errors & Omission Agreement or a Compliance Agreement?
  2. Consider compensating the borrower for his/her time and effort in obtaining the requested documents.
Strategies for Rebutting an Occupancy Allegation

• A Lender can only warrant that a borrower *intends* to occupy the property at origination.

• Intent is a state of mind and can change over time. Further, intent is a “promissory” warranty and is therefore limited to the facts in existence at the time of sale/contracting.

• A Lender can only represent that it has verified the borrower’s *intent* to occupy, based upon all the facts and circumstances of the transaction, and simply *cannot* represent that the borrower *will* actually occupy the subject property.
Fannie Mae and Freddie Mac Told to Wrap Up Claims on Pre-Conservatorship Loans

• On October 28, 2013, acting director of FHFA Edward DeMarco, issued a statement indicating that FNMA and FHLMC were directed to complete their review of loans sold prior to 2008 and issue all remaining demands for such loans by the end of 2013.

• FHFA previously confirmed that both FNMA and FHLMC were on track to issue the remaining repurchase requests by the end of the year.

• While FNMA and FHLMC should have issued their remaining demands by the end of 2013, lenders can likely expect the residual investor demands to continue to trickle down through 2014.
How to Work with the Agencies and Active Investors

• Many Investors have withdrawn from the third-party origination business, leaving Wells Fargo as the biggest Investor in the secondary market, followed by Chase and Flagstar.

• These Investors and the Agencies know that you depend upon this business relationship and will use it to force you to meet their demands.

• Things to consider when responding a repurchase demand:
  – Employ the same general rebuttal strategy;
  – Respond to the Investor’s demand within the deadline;
  – Fannie Mae’s and Freddie Mac’s new repurchase guidelines;
  – Have your attorney ghostwrite the rebuttal response for you;
  – Consider third-party recovery.

• Investors are much less likely to rescind a demand once they repurchase the loan from the Agencies or their Investors.
Part III:
The Effect of Industry Settlement Agreements

An overview of the settlement agreements between different Investors and the Agencies and the potential effects on resulting repurchase liability.
Investor Settlements with the Agencies

• Many investors have entered into settlements with Fannie Mae and Freddie Mac to resolve claims related to loans sold during the mortgage meltdown.

• These settlements are important because if the investors paid mere pennies on the dollar to settle their claims with the agencies, then the associated lenders should at least enjoy the same discount in related repurchase/make-whole requests.

• Investors should not be requesting to be “made-whole” for more than their actual damages on any loan.
A Brief Recap of Bank of America’s 2010 Settlement with the Agencies

- The settlement with Fannie Mae resolved the existing pipeline of approximately 18,000 outstanding repurchase/make-whole claims as of September 20, 2010, in relation to loans sold by legacy Countrywide to Fannie Mae.
  - Bank of America paid Fannie Mae $1.52 billion to resolve $3.1 billion in outstanding claims, or about 49 cents on the dollar.

- The global settlement with Freddie Mac resolved ALL outstanding and potential repurchase and make-whole claims related to approximately 787,000 loans sold to Freddie Mac by Countrywide through December 31st 2008.
  - Bank of America paid Freddie Mac $1.28 billion to resolve $1 billion in outstanding claims and $127 billion in potential claims sold by Countrywide through 2008. This equals only 1.01% of the outstanding amount of unpaid principal balance on the Countrywide loans owned by Freddie Mac.

- Taken as a whole, Bank of America paid approximately 40 cents on the dollar to resolve approximately $6.8 billion in original repurchase claims from the Agencies.
The 2013 Bank of America Settlement with Fannie Mae

- Bank of America has agreed to pay Fannie Mae approximately $10.3 billion to resolve current and future repurchase demands for loans delivered by Bank of America and Countrywide that were originated between January 1, 2000 and December 31, 2008.

- Pursuant to the settlement agreement, Bank of America will:
  - Make a cash payment of $3.55 billion; and
  - Repurchase approximately 30,000 loans from Fannie Mae with an unpaid principal balance and accrued interest for a total of $6.75 billion as of November 30, 2012.
The settlement agreement also provides that:

- Bank of America remains responsible to repurchase additional loans if the grounds for repurchase are based on certain excluded defects (e.g., third-party indemnification and recourse obligations with respect to the loans by the settlement).
- Fannie Mae will retain ownership of all of the loans covered by the cash settlement.

Bank of America’s Ambiguous Responses to Inquiries Regarding Agency Settlements

- BOA has been issuing inconsistent statements with regard to the effect of its settlements with the agencies on its claimed damages.
- Specifically, BOA has told some lenders that it will not discuss the terms of the settlement as such are confidential. In addition, BOA has also asserted that the settlement agreements do not apply to its claimed damages with third parties because the settlement did not limit BOA’s ability to recover from third parties.
- However, BOA has also issued further vague statements to some lenders, now claiming that the discount received in its settlement with the agencies has been allocated on some undetermined percentage of liability based upon the total unpaid principal balance of loans that were 120 days or more delinquent. BOA has also claimed that lenders are assigned full “responsibility” for these delinquent loans.
- BOA’s alleged methodology is flawed in many ways:
  - (1) BOA first claims that it has allocated some unspecified discount to the lender, then later claims that the lender was assigned “full responsibility.” Accordingly, these so-called “discounts” are not actually reflected in BOA’s claimed damages;
  - (2) Basing the alleged discount on the unpaid principal balance of the loans is flawed as many properties were liquidated, thus making the unpaid principal balance an inaccurate calculation of actual damages; and
  - (3) The pro-rata allocation based upon delinquency status fails to consider the performing, non-delinquent loans that were also included in the settlement - which would effectively lower the pro-rata share on each loan. Accordingly, BOA’s current methodology results in an inflated liability percentage – resulting in damages that are in excess of BOA’s actual damages per loan, following its settlements with the agencies.
The 2013 CitiMortgage Settlement with the Agencies

• On July 1, 2013, CitiMortgage, Inc. (“CMI”) agreed to pay Fannie Mae $968 million to resolve potential future repurchase claims for breaches of representations and warranties on 3.7 million residential first mortgage loans sold to Fannie Mae that were originated between 2000 and 2012.
  – The settlement agreement however does not release CMI’s liability with respect to a population of less than 12,000 loans originated between 2000 and 2012 with certain characteristics such as loans sold with a performance guaranty or under special credit enhancement programs.

• On September 25, 2013, CitiMortgage, Inc. (“CMI”) announced that it agreed to pay Freddie Mac $395 million to resolve potential future repurchase claims for breaches of representations and warranties on mortgage loans sold to Freddie Mac that were originated between 2000 and 2012.
Wells Fargo Settlement with Freddie Mac

- On September 27, 2013, Wells Fargo announced that it has entered into an agreement with Freddie Mac to resolve potential future repurchase claims for breaches of representations and warranties on residential mortgage loans sold to Freddie Mac prior to 2009.
- As part of the settlement agreement, Wells Fargo agreed to pay Freddie Mac $869 million to resolve the claims – which was adjusted to $780 million cash after adjusting for credits related to prior loan repurchases.
Chase Settlement with FHFA

  - Under this agreement, Chase will pay approximately $2.74 billion to Freddie Mac and $1.26 billion to Fannie Mae.
- In separate settlements, Chase also resolved claims related to the breach of representations and warranties regarding individual mortgage loans sold to Fannie Mae and Freddie Mac.
  - Under these agreements, Chase agreed to pay $670 million to Fannie Mae and $480 million to Freddie Mac.
SunTrust Settlement with the Agencies

• On October 10, 2013, SunTrust announced that it agreed to pay Fannie Mae $373 million to resolve outstanding and future claims for breaches of representations and warranties on residential mortgage loans sold to Fannie Mae between 2000 and 2012.
  – The payment to Fannie Mae will be reduced by $145 million in credits related to prior loan repurchases.

• On October 10, 2013, SunTrust announced a similar settlement with Freddie Mac. SunTrust will agreed to pay Freddie Mac $65 million to resolve outstanding and future claims for breaches of representations and warranties on residential mortgage loans sold to Freddie Mac between 2000 and 2008.
  – The payment to Freddie Mac will be reduced by $25 million in credits related to prior loan repurchases.
National Mortgage Settlement

- The agreement settles state and federal investigation findings that the country’s five largest mortgage servicers (Ally/GMAC, Bank of America, Chase, CitiMortgage, Wells Fargo) routinely engaged in abusive mortgage servicing, such as robo-signing, lost paperwork, and missed deadlines for loan modification.

- What does this mean to you?
  - If a loan is owned by Fannie Mae or Freddie Mac, then it was not included in the settlement.
  - The settlement covers loans that were foreclosed between Jan. 1, 2008 and Dec. 31, 2011.
  - We have seen at least one Investor (Chase) who rescinded the repurchase demands on loans that are covered by the settlement.
  - You should not be responsible for any losses as a result of the Investor's improper handling of the foreclosure.
Correspondent Global Settlement Strategies

- As the agencies are currently wrapping up their outstanding issues from the mortgage meltdown, many lenders would like to do the same.
- How should you change your settlement strategy in light of the various settlements between the agencies and major investors?
  - As with any negotiation, preparation is key:
    - Determine whether or not the loan was likely included in an agency settlement by identifying the end investor (Fannie Mae, Freddie Mac, etc.) and the date of sale.
    - Demand that the investor provide a detailed analysis as to how any payments made with respect to the Fannie Mae or Freddie Mac settlement were allocated to the subject loan.
    - Request that any discount that the investor enjoyed with respect to the Fannie Mae or Freddie Mac settlement be applied to the claimed damages.
Part IV:
The Current Litigation Landscape

Many Investors have taken different approaches with regard to repurchase litigation; some are more active than others. This section will discuss the current repurchase litigation trends and various settlement strategies to obtain mutually acceptable resolutions.
Decisions in Repurchase Lawsuits Remain Inconsistent

• In January of 2013, a federal judge in Florida ruled that Lehman Brothers Holdings, Inc. could not bundle eight separate loans into one single lawsuit due to the lack of commonality among the various factual circumstances pertinent to each of the eight loans. See *Lehman Brothers Holdings, Inc. v. Universal American Mortgage Company, LLC*, 11-CV-20859-JLK. Further, the Florida ruling was upheld by a Colorado judge when LBHI’s petition to consolidate the lawsuits in a Colorado court was denied on April 17, 2013.

• However, in 2011, a New York state court judge in *Syncora Guarantee, Inc. v. Countrywide Home Loans, Inc.*, held that in a case of rescission of mortgage insurance, Syncora was not required to show a direct causal link between individual breach of warranty and subsequent claim payment made pursuant to the insurance policy if the alleged misrepresentation was material. In other words, as long as Syncora could show materiality of the misrepresentations, it did not have to show breach of warranty in every loan that was at issue. Therefore, the court did not permit separate trials for separate loans.

• Some LPAs may expressly permit a lawsuit involving multiple loan repurchase claims to proceed despite individual claim differences. For those who are about to sign a new LPA with any given Investor, be sure to review the documents to see whether such a clause has been included by the Investor.
Residential Funding Company, LLC ("RFC")
Files 66 Complaints in Minnesota

- On May 14, 2012, Residential Capital, LLC filed for Chapter 11 protection in the United States Bankruptcy Court, Southern District of New York, claiming in excess of $1,000,000,000 in debt.
- RFC is a subsidiary of GMAC Residential Holding Company, LLC, which is a subsidiary of Residential Capital, LLC.
- After more than 6,000 filings, on December 11, 2013, the Bankruptcy Court issued its Order confirming the Second Amended Joint Chapter 11 Plan for Residential Capital, LLC.
- The lawsuits involve claims for Breach of Contract and Indemnification based on loans submitted to RFC by the defendants.
- RFC is looking for compensation based on Section A208 ("Events of Default") and A212 ("Indemnification") of the GMAC-RFC Client Guide.
- Residential Capital, LLC’s bankruptcy counsel from Morrison & Foerster are also listed as Of Counsel on the Complaints filed by RFC.
RFC Litigation (cont.)

• Due to the rushed filing, the Complaints are essentially the same, generic complaints with minor variations for each defendant. Specifically, paragraph 22 of each Complaint alleges the dollar value of all loans each defendant has provided during the length of the relationships between the parties.

• The dollar amounts are not always correct, nor does RFC claim that the total amounts referenced are in controversy.
  – The dollar value listed in the various Complaints run from $15,000,000 dollars to $2,000,000,000 (Wells Fargo).

• Counsel for RFC has been offering 60-day extensions of time for defendants to respond to the Complaints.

• This extension is also beneficial to RFC due to the enormity of work at hand.

• It is our understanding that RFC currently has experts reviewing the rate of default for each defendant, as well as reviewing for significant loan defects.

• Specifically, RFC claims that it suffered losses in conjunction with numerous lawsuits brought against RFC regarding defective mortgage loans sold by each defendant.
RFC Litigation Strategy

- The RFC contract is governed by Minnesota Law. Minnesota has a 6 year SOL for breach of contract claims. Accordingly, it is possible that many of RFC’s claims are barred under the SOL.

- According to Minnesota black letter law, an action based upon a breach of contract must be commenced within six years of the breach. Minn. Stat. § 541.05. subd.1(1). Specifically, a breach of contract action accrues at the time of the breach, even if actual damages occur later. Estate of Riedel by Mirick v. Life Care Ret. Communities, Inc., 505 N.W.2d 78, 81 (Minn. Ct. App. 1993).

- “A cause of action accrues when the action can be brought without being subject to dismissal for failure to state a claim.” Peggy Rose Revocable Trust v. Eppich, 640 N.W.2d 601, 609 (Minn. 2002) (citing Herrmann v. McMenomy & Severson, 590 N.W.2d 641, 643 (Minn. 1999)). Ignorance of the existence of a cause of action does not prevent the statute of limitations from running. Hermeling v. Minn. Fire and Cas., 548 N.W.2d 270, 276, (Minn. 1996), overruled on other grounds.

- Therefore, each defendant must determine the dates that the associated loans were sold and delivered to RFC.

- With regard to filing motions at this early stage, it would appear to be prudent to keep expenditures to a minimum until RFC presents more information.
At the outset, it is important to note that there is an unfavorable case in the Eighth Circuit pertaining to repurchase claims – particularly, those related to the RFC contract/guide. The Eighth Circuit includes Minnesota, so this case is controlling authority for the RFC claims.

Specifically, the Eighth Circuit held in *Residential Funding Co., LLC v. Terrace Mortgage Co.*, 725 F.3d 910 (8th Cir. 2013) that the “sole discretion” language of the RFC Seller Guide gave RFC the authority to determine whether or not an “Event of Default” triggering the repurchase indemnification obligation had occurred. The Court found that this language was clear and unambiguous and that the originator had effectively contracted away its right to judicial review of RFC’s repurchase demands.

Accordingly, this decision makes it very difficult to challenge the facts of the underlying allegations pertaining to whether or not a breach of the representations and warranties actually occurred.
Chase

- Chase has been increasingly litigious and has become more inclined to sue its Lenders for just one or two loans.


- If you are being sued by Chase, you might want to consider deposing its underwriters. According to its internal emails and employee interviews, Chase has consistently dismissed, and at times whitewashed, the negative quality-control reports about the mortgage loans so that the loans would appear healthier.
  - [http://dealbook.nytimes.com/2013/02/06/e-mails-imply-jpmorgan-knew-some-mortgage-deals-were-bad/](http://dealbook.nytimes.com/2013/02/06/e-mails-imply-jpmorgan-knew-some-mortgage-deals-were-bad/)
Lehman Brothers Holdings, Inc.

- LBHI has been quick to file suit once a repurchase demand is refused. It is not uncommon for LBHI to file suit over just one or two loans.

- The law governing the LBHI LPA is New York state law. It has a 6-year statute of limitations for a contract claim N.Y. C.P.L.R. § 213 (McKinney).

- There is much debate regarding the SOL in New York for repurchase claims. However, in light of the recent ACE Sec. decision, we recommend raising the SOL defense if you are sued by LBHI, if applicable.

- Further, most LBHI cases are filed in Colorado. As such, defendants may be able to invoke Colorado’s 3-year SOL under New York’s “borrowing statute” – depending upon the specific facts of the underlying action.

- In addition, if LBHI files suit against you for more than one loan, you might consider challenging the consolidation based upon the Universal American Mortgage Company case.
Bank of America Litigation

• Bank of America has not been very litigious as of yet with respect to repurchase actions.

• Nonetheless, several things to consider if you are served with a complaint from Bank of America:
  – Governing law: California law.
  – California’s absolute right to a jury trial.
CitiMortgage

• Citi has not been as litigious as of recent, but has previously enjoyed a windfall by litigating in the Eastern District of Missouri:
  – The court has upheld Citi’s calculation of repurchase prices (Section 2301 of the CMI Manual), which does not take into account of the adequacy and reasonableness of its liquidation procedures;
  – The court has also held that, despite the knowledge clause of Section 2(i) of the LPA, Section 11(ii) allowed Citi to demand repurchase even if the Lender complied with the CMI Manual;
  – In one case, the court held that “there can be no bad faith if [CitiMortgage] simply performed the actions expressly granted it by the parties' agreement, including determining that loans were defective and needed to be repurchased.” See CitiMortgage, Inc. v. Just Mortg., Inc., 4:09 CV 1909 DDN, 2012 WL 1060122 (E.D. Mo. Mar. 29, 2012).
• In several instances, the court has denied the Lender’s requests to depose several of the Citi whistleblowers, who have substantial knowledge about Citi’s questionable lending practices and internal quality control.
• We believe the court’s holding on the damage calculation is erroneous because the it did not consider (1) whether Citi used reasonable effort to mitigate its damages as required by law; and (2) whether it actually suffered any damages. Without analyzing these two issues, the repurchase price calculation amounts to nothing more than a penalty, which is typically unavailable in a contract dispute.
Flagstar

- Flagstar has become more litigious and has sued its correspondent Lenders for one or two loans.

- Flagstar is becoming more aggressive with regard to repurchase settlements and is usually unwilling to settle claims for less than 45 to 50 cents on the dollar.

- Flagstar typically files suit in Michigan. Accordingly, if the underlying subject property is also located in Michigan, determine whether or not the Full Credit Bid Rule might apply.
Wells Fargo

• Wells Fargo has been increasingly litigious and typically files suit in Minnesota.
• However, Wells Fargo has been open to business-to-business settlement negotiations, even after litigation has been commenced.
  – Accordingly, if Wells Fargo is threatening suit or has filed suit against you, we recommend engaging in business-to-business settlement discussions – to the extent reasonable.
• A federal judge recently rejected Wells Fargo’s bid to dismiss a U.S. government lawsuit accusing Wells Fargo of fraud. Accordingly, the case will proceed.
Franklin American Mortgage Company

- Franklin American Mortgage Company ("FAMC") has become more litigious in recent months.
- FAMC is filing suit in Tennessee as its LPA is governed by Tennessee law.
- FAMC has been inclined to sue for only one or two loans and has a litigation threshold of as little as $250,000.
- FAMC typically employs solo practitioners to pursue its claims. These attorneys often stall the litigation process, resulting in cases that drag on for long periods of time.
Litigation Settlement Strategies

• Depending on the Investor, we usually see repurchase claims settle for 30-40 cents on the dollar.
  – Claims involving indemnification agreements often settle for 50-60 cents on the dollar.

• Due to the high cost of litigation, Investors are often more willing to negotiate once litigation has commenced.

• Challenge the loss figures claimed by the Investor.

• Request that the Investor remove all prejudgment interest for the purposes of settlement negotiations.

• Consider a global settlement with the Investor to resolve all known and unknown claims.
Consider Loss Recovery Options From Applicable Third Parties

- Losses attributable to the actions and/or inactions of third parties have been accumulating on lenders’ balance sheets for years. Lenders have been forced to analyze how and against whom they may seek redress from.

- Factors to consider:
  - Is the third party still in existence?
  - Cost v. Benefit
    - What are ALL the potential costs of pursuing a third party (e.g., the investment of time, money and resources). How much is at stake?
  - Picking Your Target
    - First, identify the responsible third parties based on the underlying facts (i.e., appraisers, brokers, borrowers, etc.)
    - Second, identify and gather relevant documents, including: loan application, settlement statement, audit report, repurchase demand and damages calculation.
Part V:
FHFA New Representation and Warranties Framework

At the end of 2012, FHFA published a new representation and warranty framework for loans that are closed and sold to Fannie Mae or Freddie Mac on or after January 1, 2013.
The New Agency Representation and Warranty Framework

- The new representation and warranty framework applies to conventional loans sold or delivered on or after January 1, 2013. It aims to clarify and provide more certainty on lenders’ repurchase exposure and liability on future deliveries.
- Under this framework:
  - Lenders will be relieved of certain repurchase obligations for loans that meet specific payment requirement. For example, certain rep and warrant relief will be provided for loans with 36 months of consecutive, on-time payments.
  - HARP loans will be eligible for certain rep and warrant relief after an acceptable payment history of only 12 months following the acquisition date.
Effects of the New Framework on the Repurchase Landscape

- The new framework moves the quality control review process from the time a loan defaults to the time the loan is delivered to Fannie Mae or Freddie Mac, generally between 30 to 120 days after loan purchase.

- Lenders will likely experience an increase in the number of performing loans that are selected for review, as well as an increase in the number of upfront rejections.
Mortgage Loans Eligible For Relief Under the New Framework

- The mortgage loan must have a January 1, 2013 or later acquisition date.
- Only conventional loans are eligible. Government-insured or guaranteed loans are not eligible for the relief.
- The mortgage loan cannot have any credit enhancement (such as additional collateral, third party guarantee, etc.) other than the traditional primary mortgage insurance.
- For loans other than Fannie Mae’s Refi Plus and DU Refi Plus or Freddie Mac’s Relief Refinance Mortgage, relief is available if the borrower:
  - was not 30 days delinquent during the 36 months following the acquisition date; or
  - (1) had no more than two 30-day delinquencies and 60-day or greater delinquencies during the 36 months following the acquisition date, and (2) was current as of the 60th month following the acquisition date.
- Essentially, there are two opportunities for repurchase relief.
Eligible Mortgage Loans (cont.)

• For Fannie Mae’s Refi Plus and DU Refi Plus or Freddie Mac’s Relief Refinance Mortgage, relief is available if the borrower:
  – had no 30-day or greater delinquencies during the first 12 months following the acquisition date; or
  • Fannie Mae Refi Plus, DU Refi Plus and Freddie Mac Relief Refinance Mortgage have shorter delinquency requirements.
  – (i) had no more than two 30-day Delinquencies, and no 60-day or greater delinquencies, during the first 36 months following the acquisition date; and (ii) was current as of the 60th month following the acquisition date.
What Reps and Warrants Will a Lender Be Relieved?

- A Lender will not be required to remedy an eligible mortgage loan (i.e., repurchase, make-whole, etc.) if that loan violates Fannie Mae’s or Freddie Mac’s selling guides relating to:
  - The underwriting of the borrower, which includes the seller’s assessment of the borrower’s loan terms, credit history, employment and income, assets, and other financial information used for qualifying the borrower for the mortgage;
  - The underwriting of the subject property, which is the analysis of the description and valuation of the property to determine its adequacy as collateral for the mortgage; and
  - The underwriting of the project in which the subject property is located, which is the analysis of the PUD project, condo, or co-op in accordance with the selling guides.
Life of Loan Representation and Warranty Exclusions

- The Lender/seller will be responsible for all the following representations and warranties for the life of the loan:
  - Charter Act matters;
  - Misstatement, misrepresentation, and omissions involving (1) two or more Mortgages or related real estate transactions, and (2) made by two or more of the aforementioned parties;
    - Lender/s knowledge, or lack thereof, of the misstatement, misrepresentation, and omissions is irrelevant.
  - Data inaccuracies;
    - However, FNMA has failed to differentiate between data inaccuracies and underwriting errors.
  - Clear title/first-lien enforceability;
  - Compliance with laws and responsible lending practices; and
    - For example, following the “ability to pay” rule.
  - Single-Family mortgage product eligibility.
Fannie Mae’s New Repurchase Guidelines

• As of January 1, 2013, if a seller/servicer wishes to appeal, it must submit a written appeal with all supporting documentation related to the appeal in one consolidated package within 60 days of its receipt of Fannie Mae’s repurchase or make-whole demand. The appeal must also specifically identify (and cite) applicable sections of the Selling/Servicing Guide and/or Lender Contract that support the appeal. If no written appeal is received by Fannie Mae within the 60-day time frame, Fannie Mae will assume that the seller/servicer does not contest its requests and will not accept any further appeals for that particular matter.

• If Fannie Mae denies a timely submitted appeal, the responsible party must take one of these four actions within 15 days from the denial letter (or within any other time frame specified by Fannie Mae in writing): (1) complete the repurchase; (2) submit the make-whole payment; (3) submit a second appeal if it has additional material information; or (4) if repurchasing an active loan that will involve a transfer of servicing, the responsible party must notify Fannie Mae of the name of the new servicer and the date of the servicing transfer.

• See Fannie Mae’s Servicing Guide Announcement SVC-2012-21
Freddie Mac’s New Repurchase Guidelines

• Freddie Mac’s new purchase guidelines are substantially similar to those of Fannie Mae’s. The seller/servicer has 60 days of the issuance date of Freddie Mac’s repurchase/make-whole claim.

• If Freddie Mac denies the initial appeal and the seller/servicer discovers new information to support its contention, then it can submit a second appeal with the supporting documentation within 15 days of the denial.

• See Freddie Mac’s Industry Letter dated October 19, 2012
Tips to Minimize Future Buybacks Under the New Framework

• Implement internal procedures to ensure quality underwriting. This includes:
  – Fully comply with the underwriting guidelines.
  – Pull the credit report once more right before or on the date of the closing.
  – Ask the borrower if anything has changed since the application.
  – Put the closing agent on notice. Make a special note in the closing instructions to instruct the closing agent to watch out for any recent transactions it closed for the same borrower.
  • Request written authorization from the closing agent that the borrower and/or subject property were not involved in residential mortgage transactions within the 36 months prior to the subject transaction.
  – Consider conducting your own post-closing audit.
What Can You Do to Reduce the Risk of Liability and Position Yourself for Success?

• Be privy to the regulations affecting your business and ensure it complies with them by investing in compliance training.
• Value relationships with consumers instead of looking to make a “quick buck”.
• Ensure that your business practices are of highest INTEGRITY.
• Perform self-mock audits of your loan portfolio to ensure it complies with regulations.
• Sellers in the secondary market should audit their loans beforehand to reduce risk of liability.
• Investors in the secondary market should audit loans prior to purchase to reduce risk of liability.
• Stay focused on your goals, and execute decisions quickly!
Part VI:

Concluding Thoughts
Final Repurchase and Make-Whole Tips

- As demands on vintage loans are fading away, we anticipate a wave of repurchase demands and lawsuits from all major investors and the Agencies in response to the recent settlements. We also expect to see a faster turnaround and/or more upfront rejections on new loans under the new Agency Representation and Warranty Framework.
- Regulatory compliance should also be a lender’s top priority. A lender should always stay on top and remain updated to new regulations.
- When you receive a repurchase request:
  - Review the relevant facts in context with the applicable guidelines;
  - Determine whether or not the relevant LPA contains a “knowledge” or “awareness;”
  - Challenge the Investor’s loss figures and mitigation efforts;
  - Inquire about the Investor’s settlement with the Agencies, if applicable;
- Consider outsourcing your repurchase issues to a law firm.
- If you are signing a new LPA, have your attorney review it and watch out for certain pitfalls (i.e. make sure that that you are required to repurchase a loan only if you were aware of the defect at the time of origination).
THANK YOU!