Houston, we've got a problem - Bevilacqua

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7 Comments

On Oct. 18th, 2011 the Massachusetts Supreme Judicial Court handed down their decision in the FRANCIS J. BEVILACQUA, THIRD vs. PABLO RODRIGUEZ – and in a moment, essentially made foreclosure sales in the commonwealth over the last five years wholly void. However, some of the more polite headlines, undoubtedly in the interest of not causing wide spread panic simply put it "SJC puts foreclosure sales in doubt" or "Buyer Can't Sue After Bad Foreclosure Sale"
In essence, the ruling upheld that those who had purchased foreclosure properties that had been illegally foreclosed upon (which is virtually all foreclosure sales in the last five years), did not in fact have title to those properties.

Given the fact that more than two-thirds of all real estate transactions in the last five years have also been foreclosed properties, this creates a small problem.

The Massachusetts SJC is one of the most respected high courts in the country, other supreme courts look to these decisions for guidance, and would find it difficult to rule any other way in their own states. It is a precedent. It's an important precedent.

Here are the key components of the Bevilacqua case:

1. In holding that Bevilacqua could not make "something from nothing" (bring an action or even have standing to bring an action, when he had a title worth nothing) the lower land court applied and upheld long-standing principles of conveyance.

2. A foreclosure conducted by a non-mortgagee (which includes basically all of them over the last five years, including the landmark Ibanez case) is wholly void and passes no title to a subsequent transferee (purchasers of foreclosures will be especially pleased to learn of this)

3. Where (as in Bevilacqua) a non-mortgagee records a post-foreclosure assignment, any subsequent transferee has record notice that the foreclosure is simply void.

4. A wholly void foreclosure deed passes no title even to a supposed "bona fide purchaser"

5. The Grantee of an invalid (wholly void) foreclosure deed does not have record title, nor does any person claiming under a wholly void deed, and the decision of the lower land court properly dismissed Bevilacqua's petition.

6. The land court correctly reasoned that the remedy available to Bevilacqua was not against the wrongly foreclosed homeowner but rather against the wrongly foreclosing bank and/or perhaps the servicer (depending on who actually conducted the foreclosure)

When thinking about the implications of Bevilacqua – the importance of point six cannot be overstated.

The re-foreclosure suggestion is not valid

Re-foreclosing on these properties in not likely as has been suggested by bank lawyers in light of the Bevilacqua ruling. We aren't talking about Donald Trump here and we have a funny feeling he won't be affected either. Mostly it's guys like Bevilacqua who bought single or multi units, in the "hundreds of thousands" range. It seem unlikely that the majority of these folks would have the capital to eat their existing loses, re-foreclose at great expense, and on top of all of that come out as the highest bidder on the very property they formerly thought was their own. In many cases, as was the case in Bevilacqua, the original purchaser of the foreclosure may have already resold the property and moved on, thus leaving in their wake an even more serious problem; the likelihood of a property owner, who had nothing directly to do with a foreclosure, but is left with all the fallout of a post-Bevilacqua world. Handicapping this strategy after Eaton is affirmed should be even more fun.

Re-bidding on these properties in a re-foreclosure scenario would be done in what is soon to be a new inflationary environment (most originally bid in a deflationary environment for housing), thus making the "re-foreclosure" blank threat all the more unconvincing and unlikely.

However, it should be easy enough for investors similarly situated to Bevilacqua to simply hire fee contingent attorneys who can sue the banks and servicers for conveying fraudulent deeds – that seems like a much easier and logical proposition. When the potentially millions of lawsuits are added to the complaints filed by investors in MBS, we think the banks will finally be revealed as wholly insolvent. The only other way it could happen faster, is if the average American home owner, realizing he may never obtain clear title to his home (short of an indemnity from his bank), finally stops making his monthly payments on his invalid note (which completely lacks a valid security instrument). In this way, the existing insolvency of banks would be recognized in a matter of days rather than months or years.

The act of denial does not actually alter reality

Ostriches are said to have discovered this the hard way. On November 12th, 2010 in our article "Tattoos, Pyramid Schemes and Social

Justice" we advocated that home owners, with securitized mortgages, regardless of their ability to pay, consider suspending their mortgage payments, and place those funds into a private escrow account instead. We wrote:

> *"Radical though it may seem, we believe the only way to stop the chaos of fraud and the breakdown of the rule of law in our courts, and most importantly to ensure that we ourselves are not participants in the fraud, is for homeowners who can afford their mortgage to stop paying it..."*

The article goes on to say:

> *"For example, what is easier; to scorn those who are being foreclosed on because they can no longer afford their mortgage or to accept the possibility that our entire financial, and maybe justice system might be badly corrupted? Across all spectrums of crime, victims are often blamed, just ask attorneys who represent rape victims. This phenomenon is by no means unique to mortgage fraud, or those who have been raped by the institutions who carry out this trade. It has been made to appear as if those who have fallen on hard times are a matter of "incidental" inequalities in an otherwise procedurally just system. However, it is precisely the opposite which is true. Our financial institutions have created deliberate inequalities, through the use of procedurally unjust systems."*

We pointed out that suspending such payment might be done for the following reasons, which in light of the recent Bevilacqua decision, and the pending Eaton Decision, are increasingly being proven correct:

> *"1. They are not sure where or if their payments are going to the true note holder.*
>
> *2. They no longer know who the true note holder is.*
>
> *3. They have a legitimate concern that they may not be able to ever obtain clear title and/or title insurance (in the event of a sale) given what we now know about improperly conveyed titles and the illegitimacy of "MERS".*
>
> *4. They do not want to be an unwitting or passive participant in fraud.*
>
> *5. They care about America, want our culture to be healed and recognize the dignity of every human being."*

Long before the Ibanez decision was handed down we wrote the following (taken from the same article):

> *"If these legitimate reasons are the cause to suspend mortgage payments, then what attack on these "non-co-operators" character can be levelled? In these cases, Judge's will have to allow for proper civil procedure to take place in order for the legitimate inquiries of concerned Americans to come to light. Since banks virtually never produce adequate documentation (which appears to be by design), chances are things will escalate."*

We went on to discuss the unique risks of apathy and denial in the following:

> *"...Americans have a duty to ask critical questions about the operations of their financial institutions, and if evidence has been presented that a deal was made, but not everyone was playing by the rules, than those deals need to be looked at again. It is not good enough any longer to say, if it doesn't affect "me" than, I'm not getting involved. We have a duty to one another as Americans, and more importantly as human beings, to care about truth and justice. What's more, apathy, so long as we are not affected, is a short lived consolation. Ultimately, this crisis will affect everyone sooner or later."*

Certainly when the SJC handed down their opinion affirming Bevilacqua, perhaps hundreds of thousands, and ultimately millions of people who previously thought they were not affected, were suddenly well, affected. That is because there has been about six million foreclosures since the current economic crisis began, and those foreclosures may have resulted in many more interested parties, as was the case in Bevilacqua, who sold the subject property to four new owners, thus multiplying the number of parties involved, and ultimately the number of legal actions which could be brought. It is not hard to see where six million voided foreclosures might well result in new lawsuits in excess of that number – and if the courts advice is taken, these complaints would be directed, and properly so, at banks and servicers.

We expanded greatly on the themes of fraud, denial, and the likely economic consequences in our articles "Ibanez – Denying the Antecedent, Suppressing the Evidence and one big fat Red Herring" and "Eaton – Dividing the Mortgage Loan and Affirming the Consequent" which covered the other two recent landmark SJC cases - these may be worth reading in tandem with the present article in order to understand the full breadth of the problem.

In the Ibanez article, which was written in January of this year we wrote the following:

> *"If you live in Massachusetts and your mortgage has been securitized, or if you have purchased a foreclosure property, we think it would be wise to consider suspending your mortgage payments if you haven't already."*

We believe these particular words have become incredibly relevant given the implications of Bevilacqua.

Finally, In our article "On the ethics of mortgage loan default" we tried to cover any outstanding inhibitions homeowners might have about the advice we were giving.

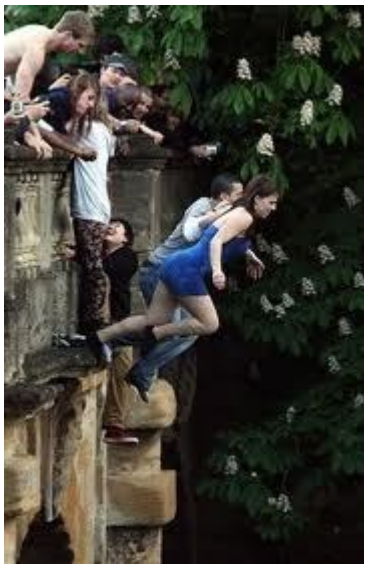
A few phone calls opens a whole new world

We decided to call a few title insurance companies to get their "take" on it all. We made the mistake of identifying ourselves as "bloggers" in the first phone call – that call may well have set a new land speed record for the fastest time from answering to hanging up. Thinking there might be a smarter approach, we decided to identify ourselves as homeowners (equally true) on the next call – the results were a little better, but only slightly.

The underwriters and title examiners we spoke to kept asking if we were attorneys, or if we represented the home owner as "council". We thought this was curious because we kept pointing out that we were ourselves just homeowners. Then it hit us, they have never actually spoken to a real, live, breathing customer on the policy origination side, they had only ever spoken to lawyer-brokers. We thought; what an interesting confluence of incentives this must create, and why is the buyer of the policy necessarily so far removed from the seller?

Follow the money trail – that's what they say. Looking for answers, follow the money trail. What is the one piece of the equation upon which all else hinges? It's not the lawyers, it's not the judiciary, the answer lies in the investment banks – but they must first pass through the gatekeepers of real estate; title insurance companies. To understand the problem does require some understand of law, but really mostly it's an understanding of finance and of business that is required above all else. Money in this case, cannot pass from bank depositor, to banker, to bank borrower in real estate transactions without the all-important "title insurance policy".

So maybe there will be a happy ending after all, for once upon a time didn't the likes of AIG insure a whole lot of CDS's for Goldman Sachs who was then paid 100 cents on the dollar (in a 43 cents on the dollar world)? That worked out well – just think of the benefits of insurance - AIG is still around, Goldman's stock price went on to quadruple in the following 18 months. The cost was relatively low, and mostly out of sight - voluntary shareholders in AIG were emancipated from their money-investment in AIG stock, and were swiftly replaced with involuntary shareholders – also known as; tax payers. It's the bankrupt companies definition of "preferred" shareholder – although it veers slightly from the traditional one.



So does it matter what lawyers, bankers, bloggers and judges think? This is America and America is all about business, and in this case, business cannot be transacted without title insurance companies, and the good thing about insurances companies is they have actuaries, and actuaries calculate risk, this is especially important since the banking community has proven that they either cannot calculate risk or are not interested in doing so. Actuaries are not exciting people, they are number crunchers, they don't do bridge jumping and they would never take inordinate risk, right?

The insurance business is interesting, even if their actuaries aren't'. That's because it's really not about making money off writing policies, anyone who knows the insurance business (or has read a 10Q, an annual report or listened to a conference call of one) knows that insurance companies make their money from investing the "float", that is to say the funds held in trust between the time policy revenue is paid in, and the time claims are paid out. It's a good business, in fact it is so good – almost everyone wants in. this business has become so robust that it even supports its own cottage industry in off-shore jurisdictions where the return on the "float" can even go untaxed - or did you think those insurance executives jets just happened to have Bermuda, The British Virgin Islands, and the Caymans stuck in their GPS just because those places have nice beaches? Although we concede they also have very nice beaches.

Needless to say it's an even better business, when you almost never have to pay out on a policy. Title insurance is unique in that way. Even the SJC conceded in Bevilacqua that this sort of "Try Title" action had not been presented before the SJC in over a hundred years. In fact, business is so good, that there is really no entry on the Profit and Loss statement of these firms for marketing expense – when was the last time you saw a TV ad, or an AD on the Internet for a title insurance company which had a better product at a better price? There is no Geico Gecko for the title insurance business. For that matter, don't hold your breath on finding a deal on title insurance through Groupon either.

This piqued our interest. We were so drawn to the prospect that the answers to a multi-trillion dollar question may lie in this little known, little observed, obscure industry that we decided to pick up the phone and call a few title examiners, underwriters and brokers. What we learned was nothing short of fascinating. First they all clammed up and didn't want to talk SJC cases. Second, they affirmed, after a bit of cajoling, that they will write a policy if any servicer gives them a "pay off" letter – we're talking a one page letter from one perfect stranger to another – insuring ownership in hundreds of thousands if not millions of dollars in real property (per transaction), and of course trillions at the nation level. This one pager could then be recorded at any local registry with precisely zero oversight.

In a world where you can't take hair conditioner on to a flight (even in all your barefoot glory), it turns out anybody can record title to a property worth large sums with absolutely no oversight or security checks. Frankly, we're beginning to feel like we've been in the wrong business all these years.

When pressed on the Eaton case, and the fact, that servicers cannot actually discharge anything (as Green Tree Servicing, LLC admitted in the uber-important Eaton case), certainly not the debt, most hung up the phone quickly – although we were exceedingly polite, professional and even gentle in our approach. These conversations, where something like being in the twilight zone. Just when we thought we had contemplated the last layer of the onion, we couldn't believe it, with just a few phone calls, the matrix of lies came streaming

down before our face yet again, like vertical lines of green computer code – apparently the underwrites took the wrong pill.

How hard would it be for the title examiners and underwriters to simply go deeper than one page, or contemplate the importance of the decisions coming out of the land court and the SJC?

The failure to perform risk assessment in the insurance underwriting business really means a lapse in fiduciary responsibility. The Absence of fiduciary responsibility means the possibility of shareholder class action lawsuits.

Conflict of Interest? You think?

So if the insurance business isn't about making money on writing policies (predicated on sound actuarial work), and if an insurance company can even lose money on underwriting as many often do, and still make a profit by investing "the float", then there may be an incentive to write policies, that reflect less than prudent risk management – that is to say losses on the underwriting side of the business would be made up on the investment side. As long as this is successful, shares in these companies can be sold to investors. The best investors are large funds like mutual funds because they buy in large junks of shares, are run by investment managers who are generally not very shrewd, and they hold long enough for insiders to sell. Large mutual funds are also the ideal investors because they have a steady stream of cash from IRA's and 401k's. IRA's and 401k's are steady sources of cash to mutual funds because most of those folks who were wise enough to envision saving, were also determined to buy and own a home (rather than rent one), thinking (perhaps wrongly), that it represented a sound investment. In this way, the loop from policy purchaser, to indirect title insurance company shareholder is complete. It's almost like a double tax on the unsuspecting home purchaser, which is subtle and goes almost entirely undetected. That's is why most homeowners have no clue who their title insurance company is, but can tell you in half a second who insures their car, their health care, or their home.

So what sort of investments are the investment managers at insurance companies making? Well, we know the insurance culture isn't fond of extreme sports, and as it turns out they're not very enterprising when it comes to their investments either – let's just say they're passive, they like fixed income, you know, a few muni's, maybe some treasuries, but above all, they like commercial bonds for their fixed income (and perceived safety), especially those which are derived from Residential Mortgage Backed Securities, or RMBS's. The feeders of these funds – the mortgage origination and securitization industry, is none other than their very own customers – think of it as one big happy love triangle, or if you happen to live in Utah and prefer their par lance "plural marriage". The title insurance companies, the mortgage origination and securitization industry and policy purchasers are like sister wives. Of course the husbands in these relationships of Asymmetrical Power, are the alchemists of the modern era, they are the engineers of derivatives, and they hide behind curtains in tall shiny buildings in an emerald city called wall street, turning their Copper into Gold. For more on this activity, it might be worth reading the article "Three Card Monte and other efficient ways of parting with your money"

Historically, title insurance companies almost never pay out. When was the last time you heard of a title insurance policy actually being used? Over the decades, it was nothing more than a simple entry on the closing HUD statement when real estate was bought or sold. Homeowners didn't' "shop" the policy, and they had no idea that when it showed up on their closing statement, that their lawyer was also a broker for the title insurance company, collecting some 70% of the premium – if they knew that, than they would know that their attorney might also have a conflict of interest when he oversaw / received the title exam, and the selection of the policy. Finding a defect or cloud on title in this circumstance meant no policy and therefore no commission – so the closing attorney's themselves were incentivized not to scrutinize too much – and why was this agency relationship never revealed? Isn't that in direct opposition to consumer protection laws?

So why were those underwriters so quick to get off the phone, as soon as we "dug a little deeper" into their criteria? Well, it's because their options don't look too good – in fact there are only two:

> a) Acknowledge that the titles to 60 mln. plus homes are badly clouded and not insurable. In which case the entire operation of writing policies, taking in premiums, investing the float in MBS's, so that mutual funds can take in funds from various and sundry retirement accounts of home owners and buy your stock suddenly stops.
>
> b) Pretend like your not aware of the problem and deny or use the more complex version "deny, deny, deny". In this operation, business can continue, at least for a while – although when the final reckoning comes, the problems will be many orders of magnitude larger.

We believe plan "B" has been the modus operandi of the industry for sometime now. However, like all parties, and indeed everything which has a beginning, this too must come to an end.

Title insurance underwriters and drug addicts; just likes peas in a pod

Why is the role of insurance companies in all of this not more closely examined? If it was an addiction we were speaking of (and maybe it is), we could think of the insurers as the "enablers", and as any good interventionist, support group, or sponsor will tell you, the enabler is as much of an addict as the addict themselves.

But what is the addiction? In a way it's money, but in another way it's something more than that. It's really power. Money of course, is power, because at the end of the day, its really a redemption slip on society, and when you possess many of these tiny slips of paper, you

effectively have much you can ask of the society around you - and that is power. The Alchemist-Engineers know this, so the jig in title insurance is really no different than the funny business that took place during the "Golden Age" of loan origination – they both follow what we might call the "the Mozilo principle".

How could we look at the addicts without looking at the enablers? Where are the insurance regulators? We marveled at the discovery that there may well exist an entire insurance industry that is predicated upon the complete lack of any sort of actuary role in it's calculation of risk, or oversight in it's conduct of business, an entire sub-species of the insurance animal where policy payouts are unheard of. In such an industry it's easy to imagine that there would be total lethargy, apathy, and greed and accordingly there is.

Further to this point, it's important to note that Bevilacqua did not just turn up yesterday, he turned up five years ago - his case was never really a true legal question, it was always a business question. It seems more business is conducted inside a court room than in marketplaces nowadays - we wonder what the chinese must be thinking of the efficiency of this model.

It could all come tumbling down suddenly

The banks settlement negotiations with the 50 states AG has focused on refinancing as a solution; why? Because refinancing ratifies, and puts good paper over bad fraudulent paper. As pointed out in "On the ethics of mortgage loan default" – that's a bad deal for homeowners. Taking an asset with bad pricing, and which had a commensurate and corrupt security interest, and improving and perfecting the security through "refinancing", but leaving the bad pricing in place (which is a direct derivative of fraud) is not a good deal for the homeowner. For a modest decrease in the monthly mortgage payment, the homeowner pays the price of somebody else's fraud (although he may not know it).

Further it may be a mistake to speak of buyers of these foreclosure properties as "innocent third parties" as the banks suddenly (at least since Bevilacqua emerged) are fond of doing. Is this characterization really accurate? We know that about two-thirds of real estate transactions over the years have been foreclosure properties; we also know that a good deal of those transactions were cash deals. Does that sound like "the Joneses"?

The buyer of a foreclosure is somewhat more enterprising than his average home buying family man cousin who buys a home because he happens to like it. The buyer of a foreclosure is by definition more of an investor than someone merely looking for shelter. This is especially true in the case at hand – Bevilacqua – who was a developer, and who turned the subject property into four separate units with four separate buyers – probably at a profit to himself, but at great harm to the buyers. In this way, the banks fraud is magnified, through the buyers of foreclosures who are more often than not, enterprising, investment minded persons, with the ability to move at greater speed than the average homesteader.

Of course nearly all home buyers are functioning in some way as investors, in so far as the overwhelming majority are purchasing the largest investment of their life. So the buyer must do proper due diligence, regardless of their place on the investor spectrum. Where there is a failure to do even basic due diligence, there is at least some accountability. However, it is not as great as the accountability of the title insurers, or the bank-sellers, who maintain superior knowledge about the "back-room dealings" of these transactions.

We only point this out so that prospective buyers of foreclosures (and also all homeowners) will pause for a moment and consider the possibilities that Bevilacqua gives rise to. The buyers of foreclosures at least are not entirely innocent as has been suggested by an industry which seeks to persuade a panel of judges and deflect away from itself the possibility of legal reprisals. Why else would the American Land title Association, and the Mortgage Bankers Associations along with their TBL's (Tall Building Lawyers), spend the time, energy and resources to file lengthy Amici Curiae briefs in Bevilacqua? It was a like a free legal defense for a small-potatoes property developer that no one had ever heard of.

Can a valid policy be written on securitized mortgage loans in light of Bevilacqua? Without the enablers, no transactions would or could ever get done. Without policies getting written, no real estate would be transacted, and yet another Pyramid would come tumbling down.

It's worth contemplating before making out that next mortgage payment. Maybe "home ownership" in the very near future simply means staying right where your at – or in the spirit of the protesters which has gripped our world - "occupying" the house your already in.

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