COUNTRYWIDE'S $8.4 BILLION SETTLEMENT OF PREDATORY-LENDING CHARGES: MUST HOLDERS OF ITS SECURITIZATIONS FOOT THE BILL?

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To settle allegations of predatory lending made by the Attorneys General of California, Illinois, and nine other states, Countrywide Financial Corporation proposes to modify the mortgage loans of some 400,000 borrowers, a proposal estimated to be worth some $8.4 billion to those borrowers. But even though it is Countrywide's own conduct (or misconduct) and the resulting liabilities that make it prudent to offer so large a settlement, Countrywide plans to pay not a cent of its own (or, rather, of its parent Bank of America) toward the $8.4 billion. Instead, it plans to impose the cost of its settlement on the trusts into which the to-be-modified loans were securitized, and thereby onto holders of certificates in those trusts. In our view, Countrywide's plan will violate the agreements that govern those trusts.

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Only a hopeless conflict of interest enables Countrywide even to think of passing the cost of its settlement to certificateholders. Wearing one hat, Countrywide originated predatory loans and sold them to securitization trusts. Wearing another, Countrywide services the loans in the trusts on behalf of the trustees and certificateholders. Countrywide as servicer now plans to modify 50,000+ loans so as extinguish the liabilities of Countrywide as predatory lender. Countrywide as servicer says these modifications will increase revenue into the trusts by avoiding the expense of foreclosure, *etc*. This assertion is laughable, for two reasons. First, if it were true, then Countrywide as servicer would be modifying those loans anyway, and the settlement between the attorneys general and Countrywide as predatory lender would convey no incremental value at all to borrowers in distress. Second, Countrywide as servicer could say nothing else without betraying the plan of Countrywide as predatory lender to shift the cost of its misconduct to certificateholders.

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Securitizations are governed by pooling and servicing agreements, and the PSAs that govern Countrywide's many securitizations are all very similar. Three provisions of those PSAs are pertinent.

First, Countrywide as lender represents and warrants that "[e]ach Mortgage Loan … complied in all material respects with applicable local, state, and federal laws, including, but not

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limited to, *all predatory and abusive lending laws.*" (Emphasis added.) [§ 2.03(b)(68).[†]] The proposed settlement makes clear that Countrywide breached this representation and warranty wholesale. Countrywide must repurchase from the trusts each loan that was not made in compliance with "all predatory and abusive lending laws," and must pay the trusts 100% of unpaid principal and interest, plus "any costs, expenses and damages incurred by the Trust Fund resulting from any violation of any predatory or abusive lending law in connection with [the] Mortgage Loan [being repurchased]." [§§ 2.03(g); 1.01 (definition of "Purchase Price").]

Second, Countrywide as servicer must "service and administer the Mortgage Loans in accordance with customary and usual standards of practice of prudent mortgage loan lenders." [§ 3.01.] Prudent lenders do not make predatory loans or spend their money to discharge the liabilities of others. In servicing and administering the loans, Countrywide "shall take no action that is inconsistent with or prejudices the interests of the Trustee or the Certificateholders." [§ 3.01.] Thus, Countrywide as servicer must act in the interests of the certificateholders, not in the interests of Countrywide as predatory lender.

Third, Countrywide as servicer may modify mortgage loans, but only five percent of them by principal amount and, more important, only if Countrywide as lender then repurchases each modified loan from the trust. [§ 3.12(a).] Countrywide as lender would argue that the unpaid principal and interest that it must pay for each loan are the reduced amounts after the modification. But no matter. As noted above, Countrywide as lender must also pay "any costs, expenses and damages incurred by the Trust Fund resulting from any violation of any predatory or abusive lending law in connection with [the] Mortgage Loan [being repurchased]." [§ 1.01 (definition of "Purchase Price").] Those "costs, expenses and damages" are precisely the difference between what Countrywide as lender pays each trust for a modified loan and the unpaid principal and interest on the loan unmodified. Those "costs, expenses and damages", according to B of A, will be at least $8.4 billion.

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Countrywide's PSAs try to make it difficult for certificateholders to enforce their rights. Countrywide and B of A must be assuming that the $8.4 billion will be spread over enough certificateholders that none will think it worth the trouble to protest. By working together for their mutual protection, certificateholders can disabuse Countrywide and B of A of this unfortunate assumption.

[†] Citations are to the sections of a typical PSA, dated September 1, 2006, and available at http://tinyurl.com/4kpb5k.