

Repurchase and Indemnification Claims in 2018 and Beyond: A Comprehensive Update

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Johnston Thomas is a full suite boutique law firm, which amongst other practices such as real estate and commercial litigation, has a nationally recognized Mortgage Banking Practice Group. With an experienced team of mortgage banking lawyers (including senior litigation attorneys, former in-house General Counsel and in-house Compliance Counsel from a well-known bank and mortgage company, etc.), certified fraud examiner(s) and forensic underwriter(s), and an extremely competent support staff, all of whom are dedicated to aggressively and competently serving the needs of our valued clientele, Johnston Thomas' Mortgage Banking Practice Group is known all across the country for the experience and results that it brings to the areas of regulatory compliance, mortgage banking litigation, and a broad range of mitigation services.

- ▶ Amongst the many legal services Johnston Thomas offers the mortgage banking industry (e.g., brokers, lenders, servicers, vendors and more), such include, but are in no way limited to, as follows:
- ▶ Mortgage Repurchase and Make-Whole Indemnification Litigation and Mitigation (e.g., Secondary Market Investors, Agencies, Bankruptcy Trustees, etc.)
- ▶ Mortgage Industry Litigation (e.g., Servicer and Sub-Servicer Disputes, 3rd Party Fraud Recovery, CPL and Title Policy Actions, Appraiser E&O Claims, Loan Officer Actions, LOS Disputes, etc.)
- ▶ Mortgage Repurchase and Make-Whole Alternative Dispute Resolution (e.g., Arbitration, Mediation, etc.)
- ▶ Regulatory Compliance, Administrative and Business Services (e.g., Mock Audits, LO Compensation, MSAs, Licensing, CA Dep't of Business Oversight, HUD Review Board, etc.)
- ▶ Transactional Matters (e.g., Drafting and Negotiating Broker and Correspondent Loan Purchase Agreements, Mergers & Acquisitions, etc.)



James W. Brody, Esq.

As the Chairman of the Mortgage Banking Practice Group, Mr. Brody actively manages all the complex mortgage banking litigation, mitigation, and compliance matters for Johnston Thomas and its diverse clientele. Being one of the founding and managing attorneys for his prior mortgage banking firm, as well as having practiced law for close to 20 years, with nearly 15 of those years being spent in the mortgage banking industry, Mr. Brody has been instrumental in the firm's development and in its continued success.

Mr. Brody has successfully resolved hundreds of mitigation and litigation cases that involve complex mortgage fraud schemes, as well as large-scale repurchase and/or make-whole disputes. Mr. Brody's experience centers on those legal issues that arise during and through loan originations, loan purchase sales, loan securitizations, foreclosures, bankruptcies, and repurchase and indemnification claims.

Overview

I. Evolving Market Conditions

II. Specific Investor Litigation and Mitigation Trends

- ▶ CitiMortgage Lawsuits and Appeals
- ▶ Lehman Bros. Holdings, Inc. Agency and RMBS Litigation
- ▶ JPMorgan Chase and Subsidiaries
- ▶ Other Repurchase and Make-Whole Lawsuits

III. Statute of Limitations Debate and Other Defenses

IV. Litigation and Mitigation Settlement Strategies

V. Third-Party Recovery Strategies

VI. Mitigating Future Risks

VII. Concluding Thoughts

Part I:

Evolving Market Conditions

Evolving Market Conditions

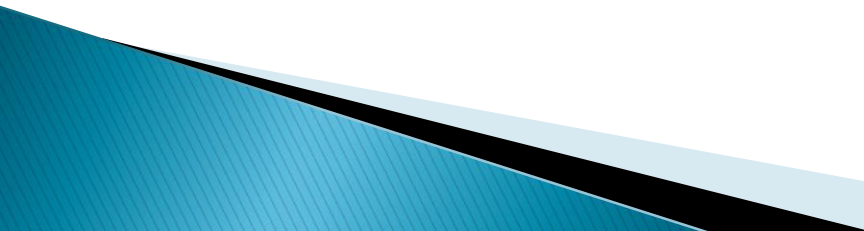
- **The Mortgage Crisis**

- Drive for home ownership (and profits)
- Creative loan products (No Income, No Asset, Stated Income, etc.)
- Easy pickings for fraudsters
- Party is over – Time to rebuild, regulate and try to learn from history

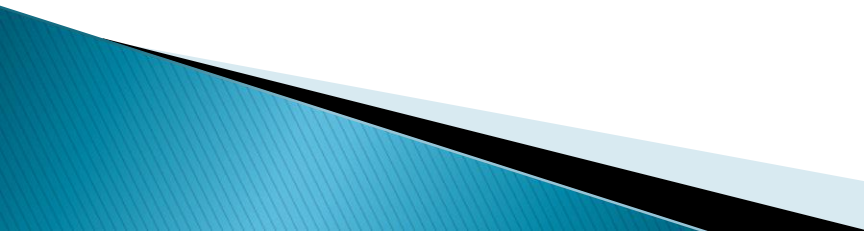
- **Business Relations**

- Still in business...still selling...how much?

- **Loan Purchase Agreements and Sellers Guides**

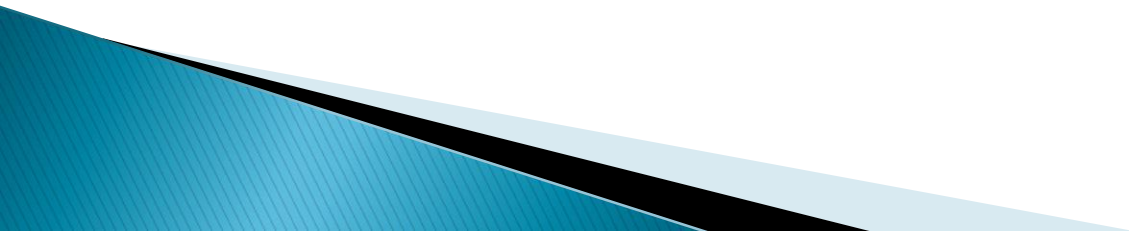
- Knowledge qualifiers disappear – sole and absolute discretion
 - Unilateral attorneys fee provisions
 - Stress business strengths / Insert materiality
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Evolving Market Conditions (...Continued)

- **Regulatory Compliance Concerns and Confusion**
 - CFPB, risk tolerance, pendulum course correction
 - **Impact of Natural Disasters (hurricanes, fires, mudslides. . .)**
 - Early Payment Defaults (“EPD”s)
 - Obtain Servicing Notes, forbearance agreements, agency policies
 - Force Majeure Clause
 - **Thinning Margins and Increasing Interest Rates**
 - **Reserve, reserve, reserve**
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Part II:

Specific Investor Litigation and Mitigation Trends



CitiMortgage Lawsuits and Appeals

- **General Thoughts and Observations re CitiMortgage Lawsuits**
 - Stated income loans – Scorched Earth tactics – seeking business – magic number 4 – appeals
- **2013 CitiMortgage Settlement with the Agencies**
 - Citi agreed to pay FNMA \$968 Million to resolve 3.7 Million 1sr mortgages sold between 2000-2012. FNMA excluded approx. 12k loans
 - Citi agreed to pay Freddie \$395 Million to resolve loans sold between 2000-2012
- **2014 Settlement to Resolve US Gov't Investigation into Mortgage Backed Securities (“MBS”)**
 - Citi reached a \$7 Billion settlement, with money going to DOJ, consumer relief, FDIC and 5 states
- **Form 200 Correspondent Loan Purchase Agreement**
 - Section 11 – Sole and exclusive discretion determination – upon notification will correct or cure within time prescribed – if unable to correct or cure, Citi then has sole discretion to either repurchase or agree to other remedies
 - Section 1 – Citi may purchase without conducting review

CitiMortgage Lawsuits and Appeals (...Continued)

- *CitiMortgage, Inc. v. Equity Bank, N.A. (8th Cir. Court of Appeals - Appellate Case No. 18-1312)*
 - Citi sent Citing Notification Letters of Agency allegations and final repurchase letters were sent after loans had been liquidated
 - Court said including repurchase price was not a condition precedent
 - Court looked at dictionary definition of repurchase AND the repurchase formula did not include purchase proceeds to get an intent of parties
 - Court denied Citi's MSJ on damages as testimony struck that deviated from repurchase formula
- *CitiMortgage v. Platinum Home Mortgage Corp. (8th Cir. Court of Appeals - Appellate Case No. 17-3158)*
 - Initial case had been under seal
 - Citi demanded repurchase within 30 days but failed to request "correct or cure" or provided prescribed time to do so
 - Could be a massive undertaking for Citi to go back and reissue all its letters

Lehman Brothers Holding, Inc. Settlement with Fannie Mae and Freddie Mac

- In early 2014, LBHI settled disputes with Fannie Mae (for \$2.15 billion) and Freddie Mac (for \$767 million) concerning over 3,000 lenders and more than 11,000 “indemnification claims.” Under the settlements, Fannie and Freddie are to assist LBHI by providing sufficient loan-level information to allow LBHI to push back its losses onto the allegedly responsible lenders.
- On May 29, 2014, LBHI filed a motion with the US Bankruptcy Court seeking mandatory mediation of the 11,000 outstanding mediation claims. Timely objections to this motion resulted in correspondent lenders obtaining right to choose the mediator and shift mediation costs to LBHI. LBHI had used this process to leverage pre-mediation resolutions.
- Judge Shelley Chapman denied correspondent lenders efforts to dismiss the resulting adversary based upon Statute of Limitations grounds, and after very lengthy delays, the 140+/- correspondent lender defendants, whom it still remains a mystery how they were named out of the 3,000 lenders, recently heard the Defendants Omnibus Motion to Dismiss, based upon lack of subject matter jurisdiction and improper venue, which most independent observers believe will **not** be granted.

Lehman Bros. Holdings, Inc. RMBS Settlement and Coming Wave of Indemnification Claims

- On March 8, 2018, U.S. Bankruptcy Court Judge Shelley Chapman sided with LBHI, after a 22 day trial, and ruled that certain claims brought by RMBS trustees were valued at \$2.38 Billion and not the \$11.4 Billion that was estimated by the trustees. This was spelled out in a 100 page decision.
- The RMBS Trustees had complained that Lehman Brothers had sold billions of dollars of loans that contained misrepresentations, which loans were securitized before its 2008 collapse. There are approximately 70,000 loans at issue in the dispute and all indications are that LBHI will now turn to correspondents in the same manner it had with the Agency loans.
- Unless your company is presently involved in the current Agency litigation, the best action to take is to see *if your company was named on the service list* and, if so, simply make sure that you keep an eye out for the expected wave of demands to be made and then proceed accordingly. There are a lot of good facts developed in the RMBS litigation that can then be drawn from as part of an aggressive defense. The Notice of Service List, should your company name be listed therein, was likely done to preclude one of the potential defenses that may otherwise be asserted for contractual indemnity claims, which is a “failure to give notice.”
- This will represent the 4th wave of litigation, with the 4 waves including: (1) suing lenders in their home jurisdictions; (2) suing lenders in Colorado; (3) suing lenders in the NY Bankruptcy Court on Agency Loans; and (4) RMBS litigation.

JPMorgan Chase & Co, Including Subsidiaries Such As EMC Mortgage, LLC

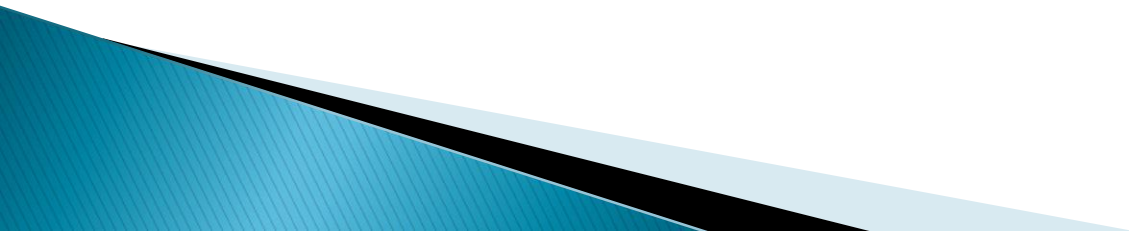
- JPMorgan Chase begins sending out demand letters concerning loans sold to Chase, EMC and Bear Stearns prior to 2008, which loans had then been pooled with loans it had originated on a retail basis and then deposited with RMBS Trusts. Investors then sued Chase, alleging securities fraud and other causes of action, which Chase ultimately settled and paid in excess of \$4 Billion on December 27, 2017.
- Demand letters being sent out by Chase include confidentiality agreement and allege damages as being arrived at “. . .by taking the amount of the trust settlement, as well as the amount of the associated expenses, and then allocating the payments to or attributable to each trust among the originators of loans in that trust based, generally, upon the relative losses caused by each originator’s loans.”
- Next steps in addressing and defending against these new claims – Negotiate the terms of the proposed NDA at the outset and then begin the review to put together a strong set of defenses.

Other Repurchase and/or Make-Whole Mitigation and Litigation Claims

- ResCap Liquidating Trust / RFC
 - After filing lawsuits against 65 +/- Defendants in the State of Minnesota, which litigation had lasted years and involved massive amounts of money, ResCap proceeded to pursue correspondent lenders outside of Court.
- Franklin American Mortgage Co.
- FDIC
- Bank of America / Countrywide
 - All bark and no bite? Claims at an end? Given the statute of limitations in CA, which state's law governs the contracts we have negotiated, it is entirely possible.
- Planet Home Loans

Part III:

Statute of Limitations Debate and Other Defenses



Statute of Limitations for Specific Investor LPAs

- **Lehman Brothers Holdings, Inc.** – there are three potential SOL periods involved:
 - ▶ 6 years (N.Y. C.P.L.R. §213 (McKinney) (Lehman LPAs contain a choice of law provision citing NY law).
 - ▶ 3 years (N.Y. C.P.L.R. §213; 10 Del Code section 8106) (LBB, which purchased most relevant loans and assigned them to LBHI, principal place of business was in Delaware implicating NY’s “borrowing statute”).
 - ▶ 3 years (Colorado Revised Statutes section 13-80-101) (Aurora Bank, which acquired or merged with Lehman Brothers Bank, FSB has their principal place of business in Colorado).
- **GMAC/Ally Bank** – 6 years (Minn. Stat. §541.05, subd. 1(1)).
- **Bank of America** - 4 years (Cal. Civ. Proc. Code §337).
- **JPMorgan Chase** - 6 years (N.J. Stat. Ann. §2A: 14-1; N.Y. C.P.L.R. §213 (McKinney)).
- **CitiMortgage** – 10 years for contract disputes over payment of money (Mo. Ann. Stat. §516.110; 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)).
- **Franklin America Mortgage Company** – 6 years (Tenn. Code Ann. §28-3-109).
- **US Bank** – 6 years (Wis. Stat. Ann. §893.43).

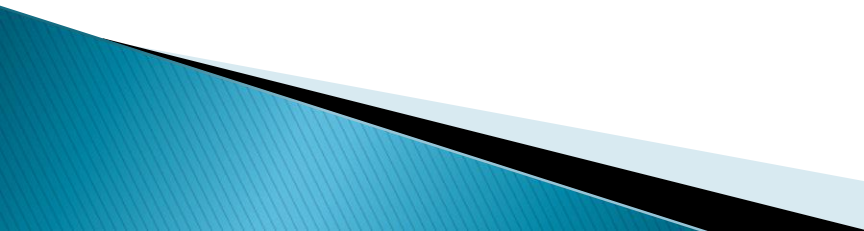
Statute of Limitations Debate

- Investors often argue that the statute of limitations (“SOL”) does not begin to run until a repurchase demand is refused by a lender, while lenders generally argue that the SOL begins to run on the date of breach, generally the date of sale, though this date may be later in the case of an early payment default.
- Certain courts applying New York state law have held that repurchase and indemnification are mere remedies; therefore the breach accrues on the date that the loan is transferred as part of the relevant loan purchase agreement (“LPA”).
- A four judge appeals panel in New York unanimously ruled that repurchase claims, “did not accrue until defendant either failed to timely cure or repurchase defective mortgage loan, but rather, “accrued on the closing date of the [LPA].” *Ace Securities Corp. v. DB Structured Products, Inc.*, 2013 WL 6670379 (New York Supreme Court, Appellate Division, No. 11384 and M-5893, M-6111 and M-6133, December 19, 2013). However, this decision is now up on appeal before New York’s highest court.
- A federal judge in Washington State, applying New York state law, ruled 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 the investor purchased the loan from the originator. See *LBHI v. Evergreen*, 793 F. Supp. 2d 1189 (2011).

Statute of Limitations Debate (...Continued)

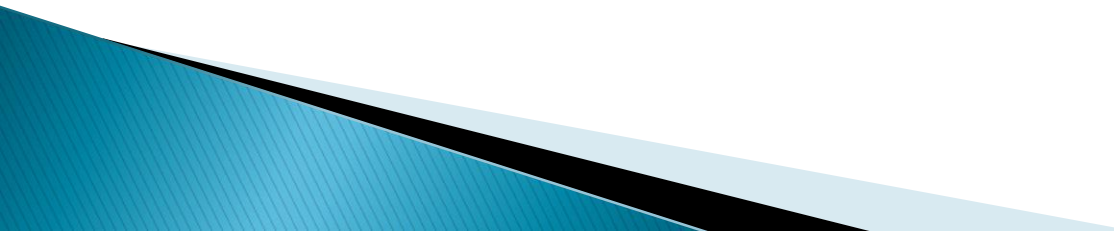
- See also, *Hahn Automotive Warehouse, Inc. v. Am. Zurich Ins. Co.*, 81 A.D.3d 1331, 916 N.Y.S.2d 678, 680 (2011), holding that “[a] cause of action for breach of contract accrues when the party making the claim possesses a legal right to demand payment...To find otherwise would allow an Investor to circumvent the statute of limitations by deferring its demand.”
- See also, *Wells Fargo Bank, N.A. v. JPMorgan Chase Bank, N.A.*, 2014 WL 1259630 (S.D.N.Y. **March 27, 2014**) holding that, when a contract involves a repurchase clause, “the general rule in New York is that ‘the cause of action accrues when the party making the claim possesses a legal right’ to make the demand, not when the demand actually occurs.”
- Conversely, Investors point to *LBHI v. National Bank of Arkansas (“NBA”)*, which supports the position that a separate breach occurs when the originator fails to repurchase a loan, as required by contract.
- Note that much of the current SOL debate applies to NY state law and therefore only is controlling as to LPA’s which are governed by New York law, such as LBHI and Chase.

Defense of Causation

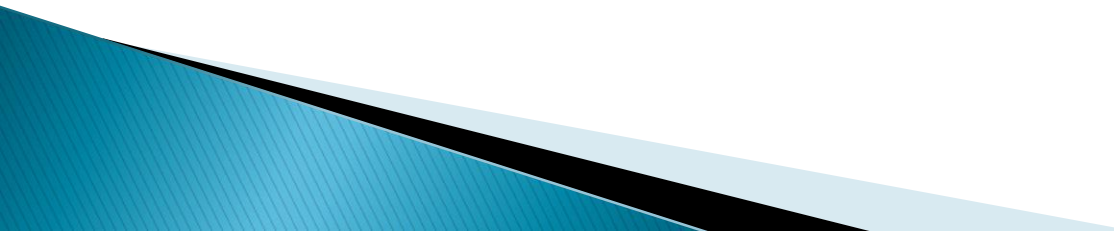
- ▶ Another issue that can arise as a result of investor repurchase and indemnification demands is the issue of causation. Can an investor show that the alleged breach of representations and warranties under the LPA on individual loans actually resulted in the damages the investor is claiming from their global settlements with the Agencies?
 - ▶ Major investors entering into global settlements with Fannie Mae or Freddie Mac are often unable to provide verifiable damage calculations on allegedly defective loans that were included as part of these settlements. These investors are unable to show there is a direct correlation or causal connection between the settlement damages they are claiming reimbursement/indemnification for and the defects they are alleging actually breached the representations or warranties under the LPA.
 - ▶ This creates problems for lenders and originators because they are unable to verify, at the individual loan level, whether claimed defects with the loans actually caused the damages some investors are claiming.
 - ▶ The issue of causation can overlap with claims of fraud and misrepresentation under the representations and warranties made in LPAs, which are tort claims requiring a showing of direct and proximate causation.
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Part IV:

Litigation and Mitigation Settlement Strategies



Litigation and Mitigation Settlement Strategies

- Depending on the investor, repurchase claims settle for an average of 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.
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Part V:

Third-Party Recovery Strategies



Third-Party Loss Mitigation / Recovery

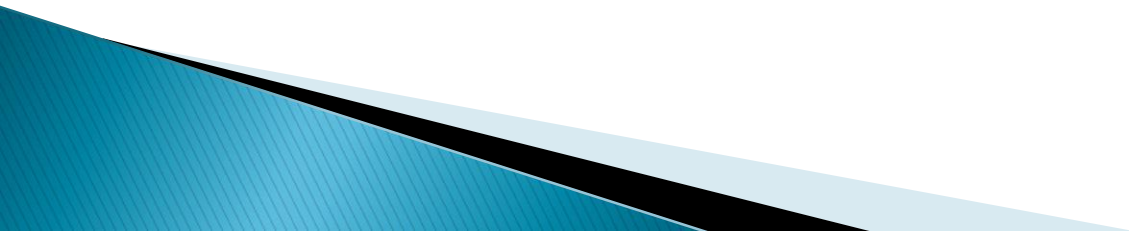
Whenever you are faced with a demand to repurchase and/or indemnify an investor or agency, companies should do more than merely look at defensive strategies and should always consider whether there are any options to recover on alleged claims from other potentially culpable third-parties.

In other words, as 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 include, but are not limited to, the following:

- Balancing defense strategy against third-party recovery strategy
- 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 targets
 - First, identify the responsible third parties based on the underlying facts (i.e., appraisers, brokers, borrowers, etc.).
 - Second, confirm the third party is still in existence.
 - Third, identify and gather relevant documents, including: loan application, settlement statement, audit report, repurchase demand and damages calculation

Part VI:

Mitigating Future Risks

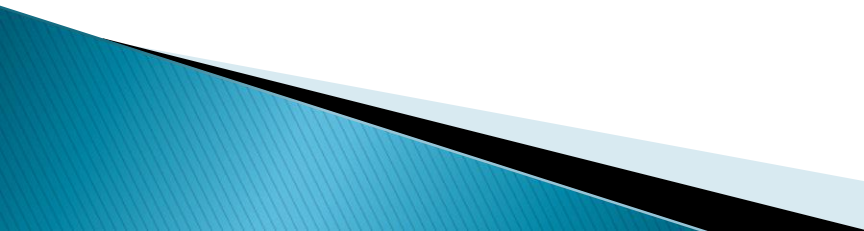


Mitigating Future Risks

- Negotiating terms of LPAs and Seller Guides

- Volume of business dictates leverage
- Materiality qualifiers
- Notice periods
- Unilateral vs. Mutual Attorneys' Fees provisions
 - In 7 states, unilateral attorneys' fees clauses are automatically treated as bilateral; a reciprocal attorneys' fees right is read into the contract by statute. These include California (Cal. Civ. Code Section 1717); Florida (Fla. Stat. Ann. Section 57.107(7)); Hawaii (Haw. Rev. Stat. section 607-14); Montana (Mont. Code. Ann. Section 28-3-704); Oregon (Or. Rev. Stat. Ann. Section 20.096); Utah (Utah Code Ann. Section 78B-5-826); and Washington (Wash. Rev. Code. Ann. Section 4.84.330).
 - Arizona implies reciprocal attorneys' fees by decisional authority rather **than statute**.
- Knowledge qualifiers? Good luck...

- Negotiating terms of Broker Agreements

- Lenders sit in seat of investors
 - Brokers sit in seat of lenders
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Mitigating Future Risks (...Continued)

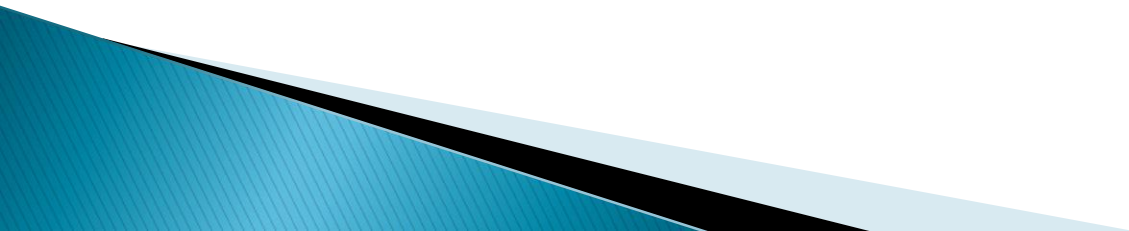
- Setting Appropriate Reserves
- Improved Quality Control Procedures

Implement internal procedures to ensure quality underwriting. This includes, but is in no way limited to, as follows:

- Fully complying with the underwriting guidelines.
- Pulling the credit report once more right before or on the date of the closing.
- Asking the borrower if anything has changed since the application.
- Putting 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.
- Considering conducting your own post-closing audit.

Part VII:

Concluding Thoughts



Concluding Thoughts

- As demands on vintage loans are fading away, we anticipate a wave of repurchase demands and lawsuits on RMBS or private label loans. 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" clause;
 - Challenge the investor's loss figures and mitigation efforts; and
 - Inquire about the Investor's settlement with the agencies, if applicable;
- Consider outsourcing your repurchase issues to a law firm.

QUESTIONS & ANSWERS

At the conclusion of this webinar, in the event we do not have sufficient time for Q&A, please submit your questions directly to the moderator, at jbrody@johnstonthomas.com. Thereafter, Johnston Thomas will prepare a supplemental FAQ Memo that will be sent to each of the registered attendees.

THANK YOU!