

# DID SERVICERS COMMIT FRAUD SO BANKSTERS COULD GET BIG BONUSES?

When I asked yesterday about the relationship between the stress tests and the servicers' foreclosure fraud, I had a hunch that the banksters might have been committing that fraud so as to be able to show financial viability so as to be able to repay TARP funds so as to escape the oversight of the government. I wondered whether the stress tests were not just a means by which the government should have exercised some control over the servicers that they already knew to be having problems, but were also one reason the servicers were pushing for the most profitable outcomes (including choosing to foreclose rather than modify loans).

Rortybomb, who knows a lot more about how this stuff worked than I do, provides these damning details:

For what it is worth, I'm sure those conducting the stress test knew that this conflict existed and knew that it was very profitable to the banks. Servicing is considered a "hedge", because as the origination business dries up foreclosures will increase and servicing income would go up, something Countrywide and others loved to talk about.

Let's go to a Countrywide Earnings call from Q3 2007:

Now, we are frequently asked what the impact on our servicing costs and earnings will be from increased delinquencies and lost mitigation efforts, and what happens to costs. And what we point out is, as I will now, is

that increased operating expenses in times like this tend to be fully offset by increases in ancillary income in our servicing operation, greater fee income from items like late charges, and importantly from in-sourced vendor functions that represent part of our diversification strategy, a counter-cyclical diversification strategy such as our businesses involved in foreclosure trustee and default title services and property inspection services.

The servicing operation will “fully offset” lost income from increased delinquencies and lack of origination business. This is by design. It’s tough to find good counter-cyclical strategies, but this appears to be one. If you were both TBTF and really in need of cash, could you squeeze this a bit further, say by violating the rule of law?

[snip]

Someone enterprising on the hill could ask how the servicing income was incorporated into the stress test and how predictive it was in the adverse scenario case. Things like this make it even more important that the government takes a strong hand in rooting out foreclosure fraud. We cannot allow an impression to form that we collectively looked the other way at issues of foreclosure abuse, issues well documented since before the stress test, because this business line is one of the few profitable things available to TBTF firms. TBTF firms that needed cash, were (and are) backstopped by taxpayers and wanted to get out of TARP to issue bonuses. Nobody gets to be above the

law, regardless of how systemically important they are or whatever numbers needed to be hit on the stress test.

In other words, going back to 2007, mortgage companies were upfront in claiming that their servicer-related profits served to offset their loan losses. That's not to say they would have argued that in their stress test results (again, I'm not expert on this, but I'm not even sure that the stress tests looked at the servicer income). But it does say that to prove viability—to make a half-credible claim they weren't insolvent and to evade restrictions on bonuses and political giving—they had an incentive to suggest their servicer income was enough to offset a significant chunk of their loan losses. That not only gave them a huge incentive to keep servicer costs low (by doing things like hiring WalMart greeters and hair stylists to serve as robo-signers), but it also increased the incentive to increase profits as a servicer by refusing to modify loans.

So I'd go further than Rortybomb in calling for some enterprising Hill person to look into this. Given that we know Timmeh Geither, campaigner against injustice, was officially warned and knew about this conflict, I'd like to know how much he knew about this hedge. The Administration now says it was helpless to stop this kind of fraud, yet it chose not to use at least two sources of leverage (cramdown and stress tests) to control it. Is that because they knew the servicer fraud was an important part of extend and pretend?