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# N.Y. Fed May Require Banks to Buy Back Faulty Loans

By Dawn Kopecki and Jody Shenn

Aug. 4 (Bloomberg) -- The Federal Reserve Bank of New York may seek to require banks to buy back its holdings of faulty mortgages and other assets acquired through the rescues of Bear Stearns Cos. and [American International Group Inc.](#), a spokesman said.

“We are involved in multiple efforts related to exercising our rights as investors in non-agency RMBS or CDO securities,” New York Fed spokesman [Jack Gutt](#) wrote in an e-mail, referring to residential [mortgage-backed securities](#) and collateralized debt obligations.

Steps include “those that require originators to repurchase ineligible loans,” Gutt wrote, referring to ones that aren’t backed by federal entities and violate bond contracts. “These efforts support our primary goal of maximizing the value of these [portfolios](#) on behalf of the American taxpayer.”

The Federal Reserve, Fannie Mae, Freddie Mac and other mortgage investors are seeking to force buybacks to rid their books of bad assets amid persistent losses from soured housing loans. Debt buyers and insurers, who can rescind their coverage, are combing through loan documents for faulty appraisals, inflated borrower incomes and missing documentation that can trigger contractual agreements to repurchase ineligible assets as insurers seek ways to void coverage or recoup costs.

“Of course the Fed should pursue ‘efforts to exercise our rights as investors,’” said [Chris Kotowski](#), a bank analyst at Oppenheimer & Co. in New York. “The only real question is, what took them so long?”

## Maiden Lane

Regulators of Fannie Mae and Freddie Mae last month issued 64 subpoenas to loan servicers and mortgage-bond trustees. Investigators are seeking loan files that may prove the two government-supported companies bought securities backed by loans that sellers should buy back because they misrepresented their quality.

The New York Fed holds \$69.1 billion of assets that were placed in three holding companies that it established to bail out AIG and Bear Stearns in 2008. Maiden Lane LLC, named for the street bordering the New York Fed’s Manhattan headquarters, acquired about \$30 billion of Bear Stearns assets that [JPMorgan Chase & Co.](#) didn’t want when it bought the company. Maiden Lane II and III, which

were involved in AIG's rescue, hold the remaining assets.

Issuers of so-called non-agency mortgage securities held by the three Maiden Lane companies include Countrywide Financial Corp., which was bought by [Bank of America Corp.](#), Bear Stearns, [Goldman Sachs Group Inc.](#) and [UBS AG](#), as well as defunct lenders such as New Century Financial Corp., according to Fed disclosures.

\$5 Billion

Any potential losses won't hit bank earnings for some time to come, said [Scott Buchta](#), a mortgage-bond strategist at Braver Stern Securities in Chicago.

"As far as making actual recoveries goes, this process just begins with the Fed receiving loan files," Buchta said. "They then need to comb through all of the files and try to find the breaches."

Many of the assets in the Fed's portfolio are distressed. About 78 percent of the assets backing Maiden Lane II, valued at \$16.2 billion on the Fed's balance sheet as of July 28, were considered junk bonds at the end of the first quarter, compared with 65 percent a year earlier, according to the Fed.

Violations of so-called representations and warranties of loans sold directly to or insured by Fannie Mae and Freddie Mac cost the [four biggest](#) U.S. lenders about \$5 billion last year.

The statement by the New York Fed, which is being advised by BlackRock Inc. on the portfolios, comes as investors in the almost \$1.5 trillion non-agency mortgage bond [market](#), which doesn't have government backing, escalate efforts to minimize their losses.

More Efforts

A group of investors holding more than \$500 billion of the debt last month sent letters to trustees seeking their help in getting more bad loans bought back, according to Dallas lawyer Talcott Franklin. Franklin wouldn't name the investors, and declined to comment today on whether they included the Fed.

Investors suspect that loan servicers -- who are responsible for pursuing repurchases and handling billing, collections and loan modifications -- may not be seeking as many as possible, in part because other units of their companies would be the ones required to take back the debt, according to the letters.

Investors who are sharing information and coordinating through Talcott Franklin PC collectively own bonds giving them 25 percent of "voting rights" in about 2,300 deals, and more in a smaller number, the lawyer said in a July 22 interview. Those levels exceed thresholds that allow them to force actions such as declaring loan

servicers in default of their contracts, requiring them to share loan files, and replacing trustees, with details varying by the deal, he said.

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*Last Updated: August 4, 2010 16:39 EDT*

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