



Subordinate Investors Prevail in MBS Lawsuit

December 21, 2023

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A New York Supreme Court judge recently ruled in favor of subordinate investors in a case involving \$400 million in recoveries stemming from modified mortgages in 36 non-agency MBS.

The loans were modified under the Department of Treasury's Home Affordable Modification Program, which was designed to help homeowners impacted by the 2008 financial crisis avoid foreclosure.

At the time of modification, the deferred amounts were written off as a loss. However, with the housing market having recovered since then, some homeowners sold or refinanced their homes, resulting in the repayment of the deferred principal amounts.

Wells Fargo, the trustee on the MBS in the lawsuit, treated the repayments as a recovery of prior losses to senior bond holders, despite the New York Supreme Court in 2020 finding that only subordinate tranches of MBS are entitled to be written up from subsequently recovered principal repayments.

After being notified of the error by subordinate investors, Wells requested court approval to change its policy to write up subordinate tranches consistent with the 2020 ruling.

Senior bondholders opposed the change and were expecting to have the case heard by the New York Supreme Court. However, Justice Andrew Borrok determined that no trial was needed as the issue was already settled in 2020 and Wells could resume changing its policy to write up subordinate tranches consistent with the previous ruling.

The case is on appeal following Borrok's judgement.

Courtney Statfeld, a principal at McKool Smith who represented subordinate investors in the case, told Inside MBS & ABS that the lawsuit has caused a chain reaction for other cases involving MBS subsequent recoveries and clean-up call price calculations, including a U.S. Bank case that has been placed on a stay pending resolution of the most recent case's appeal.

"The Wells case has implications for other trustees and affirmation of the decision that forbore principal, and payback of subsequent recovery, has implications for the 'called deals cases' as we call them," Statfeld said.

According to Statfeld, the Wells case followed a recent pattern set by MBS trustees that decided to take cases involving certificate holders to court instead of taking definitive stances on their own.

Statfeld noted that over the last three years she has seen trustees prefer to take MBS cases to court using the Article 77 procedure, which gives New York's state supreme court jurisdiction over cases involving trusts.

"Trustees get competing instructions amongst certificate holders, and so instead of taking a definitive stance, they'll say this is what we have been doing and we are going to get a court blessing that what we have been doing is right or the court will simply tell us we're wrong — and that's cost certificate holders a lot of money in litigation," Statfeld said.

