Can Limiting a 400-Year-Old Law Fix the Foreclosure Crisis?

Ways to expedite the foreclosure process for abandoned properties and to preserve homeowners’ defenses in foreclosure actions are urgently needed. But the defects of the US home foreclosure system—poor communication, inconsistent requirements, foreclosure delays, devastated neighborhoods, and misaligned incentives—are standing firmly in the way, and it will take much imagination and stamina to push them aside. Maybe limiting the application of a 400-year-old law has the strength to push at least one of them.

The holder-in-due-course rule protects mortgage loan purchasers from liability for originators’ wrongful conduct, such as lying about the terms of the loan. After the tsunami of mortgage foreclosures hit the Cleveland area in 2007, Cleveland Fed President Sandra Pianalto argued that laws responding to the home foreclosure crisis should align appropriate incentives with desired behaviors. Since that time, researchers at the Cleveland Fed have published their opinions on the issue, arguing that the ancient rule creates incentives for undesirable behaviors. The rule’s protection led many loan purchasers to close their eyes to originators’ actions because purchasers could collect loan payments, as stated in the paperwork, despite originators’ misrepresentations.

A Cleveland Fed working paper advocated in 2008 for limiting the rule’s application to home mortgage loans. Its authors still advocate that today.

Application of the rule had already been limited in consumer goods and services transactions, as well as high-cost mortgage transactions; action limiting its application to the entire home finance market is long overdue. Such action would prompt mortgage loan purchasers to police originators’ behavior, because they would be legally responsible for originators’ misconduct. Although this policing would probably entail a small cost increase, it would reduce the overall long-term cost of home mortgage loans to borrowers and lenders, make banks more attractive loan originators, and bolster the stability of the financial system.

The Uniform Law Commission (ULC), a group of state-government-appointed lawyers, judges, and legislators who work for the uniformity of state laws, formed a committee in 2012 to draft a uniform act for consideration by the states to improve the foreclosure system. After presenting a draft of the Home Foreclosure Procedures Act at the ULC’s annual meeting in July 2013, the commission voted to continue work on the uniform law, including the development of a proposal to limit the holder-in-due-course rule.

The committee will submit another draft at the 2014 annual meeting of the Commission on July 11–17. Whether they will adopt, reject, or defer action on the proposal remains to be seen. In the meantime, citizens’ input and feedback is needed if the law is to achieve its objectives. The committee welcomes written remarks and encourages observers to speak at its meetings.

—Mark Greenlee, Counsel

Researchers advocate for a unique tactic geared toward home mortgage foreclosure reform.

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