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Bankers Ignored Signs of Trouble on Foreclosures

By ERIC DASH and NELSON D. SCHWARTZ

At JPMorgan Chase & Company, they were derided as "Burger King kids" — walk-in hires who were so inexperienced they barely knew what a mortgage was.

At Citigroup and GMAC, dotting the i's and crossing the t's on home foreclosures was outsourced to frazzled workers who sometimes tossed the paperwork into the garbage.

And at Litton Loan Servicing, an arm of Goldman Sachs, employees processed foreclosure documents so quickly that they barely had time to see what they were signing.

"I don't know the ins and outs of the loan," a Litton employee said in a deposition last year. "I'm not a loan officer."

As the furor grows over lenders' efforts to sidestep legal rules in their zeal to reclaim homes from delinquent borrowers, these and other banks insist that they have been overwhelmed by the housing collapse.

But interviews with bank employees, executives and federal regulators suggest that this mess was years in the making and came as little surprise to industry insiders and government officials. The issue gained new urgency on Wednesday, when all 50 state attorneys general announced that they would investigate foreclosure practices. That news came on the same day that JPMorgan Chase acknowledged that it had not used the nation's largest electronic mortgage tracking system, MERS, in foreclosures, since 2008.

That system has been faulted for losing documents and other sloppy practices.

The root of today's problems goes back to the boom years, when home prices were soaring and banks pursued profit while paying less attention to the business of mortgage servicing, or collecting and processing monthly payments from homeowners.

Banks spent billions of dollars in the good times to build vast mortgage machines that made new loans, bundled them into securities and sold those investments worldwide. Lowly servicing became an afterthought. Even after the housing bubble began to burst, many of these operations languished with inadequate staffing and outmoded technology, despite warnings from regulators.

When borrowers began to default in droves, banks found themselves in a never-ending game of catch-up, unable to devote enough manpower to modify, or ease the terms of, loans to millions of customers on the verge of losing their homes. Now banks are ill-equipped to deal the foreclosure process.

"We waited and waited and waited for wide-scale loan modifications," said Sheila C. Bair, the chairwoman of the Federal Deposit Insurance Corporation, one of the first government officials to call on the industry to take action. "They never owned up to all the problems leading to the mortgage crisis. They have always downplayed it."

In recent weeks, revelations that mortgage servicers failed to accurately document the seizure and sale of tens of thousands of homes have caused a public uproar and prompted lenders like Bank of America, JPMorgan Chase and Ally Bank, which is owned by GMAC, to halt foreclosures in many states.

Even before the political outcry, many of the banks shifted employees into their mortgage servicing units and beefed up hiring. Wells Fargo, for instance, has nearly doubled the number of workers in its mortgage modification unit over the last year, to about 17,000, while Citigroup added some 2,000 employees since 2007, bringing the total to 5,000.

“We believe we responded appropriately to staff up to meet the increased volume,” said Mark Rodgers, a spokesman for Citigroup.

Some industry executives add that they’re committed to helping homeowners but concede they were slow to ramp up. “In hindsight, we were all slow to jump on the issue,” said Michael J. Heid, co-president of at Wells Fargo Home Mortgage. “When you think about what it costs to add 10,000 people, that is a substantial investment in time and money along with the computers, training and system changes involved.”

Other officials say as foreclosures were beginning to spike as early as 2007, no one could have imagined how rapidly they would reach their current level. About 11.5 percent of borrowers are in default today, up from 5.7 percent from two years earlier.

“The systems were not ever that great to begin with, but you didn’t have that much strain on them,” said Jim Miller, who previously oversaw the mortgage servicing units for troubled borrowers at Citigroup, Chase and Capitol One. “I don’t think anybody anticipated this thing getting as bad as it did.”

Almost overnight, what had been a factorylike business that relied on workers with high school educations to process monthly payments needed to come up with a custom-made operation that could solve the problems of individual homeowners. Gregory Hebner, the president of the MOS Group, a California loan modification company that works closely with service companies, likened it to transforming McDonald’s into a gourmet eatery. “You are already in chase mode, and you never catch up,” he said.

To make matters worse, the banks had few financial incentives to invest in their servicing operations, several former executives said. A mortgage generates an annual fee equal to only about 0.25 percent of the loan's total value, or about $500 a year on a typical $200,000 mortgage. That revenue evaporates once a loan becomes delinquent, while the cost of a foreclosure can easily reach $2,500 and devour the meager profits generated from handling healthy loans.

"Investment in people, training, and technology — all that costs them a lot of money, and they have no incentive to staff up," said Taj Bindra, who oversaw Washington Mutual's large mortgage servicing unit from 2004 to 2006.

And even when banks did begin hiring to deal with the avalanche of defaults, they often turned to workers with minimal qualifications or work experience, employees a former JPMorgan executive characterized as the "Burger King kids." In many cases, the banks outsourced their foreclosure operations to law firms like that of David J. Stern, of Florida, which served clients like Citigroup, GMAC and others. Mr. Stern hired outsourcing firms in Guam and the Philippines to help.

The result was chaos, said Tammie Lou Kapusta, a former employee of Mr. Stern's who was deposed by the Florida attorney general's office last month. "The girls would come out on the floor not knowing what they were doing," she said. "Mortgages would get placed in different files. They would get thrown out. There was just no real organization when it came to the original documents."

Citigroup and GMAC say they are no longer giving any new work to Mr. Stern's firm.

In some cases, even steps that were supposed to ease the situation, like the federal program aimed at helping homeowners modify their mortgages to reduce what they owed, had actually contributed to the mess. Loan servicing companies complain that bureaucratic requirements are constantly changed by Washington, forcing them to overhaul an already byzantine process that involves nearly 250 steps.

This article has been revised to reflect the following correction:

Correction: October 14, 2010

A photo caption with an earlier version of this article referred incorrectly to documents related to foreclosures. They are depositions from robosigners, not lawsuits.

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