New York Times, August 14, 2010

By GRETCHEN MORGENSON

MEET Brad Miller, a Democratic representative from North Carolina who was elected to Congress in 2002, talks straight and understands how big banks can put consumers at peril.

He is worth getting to know, not only because of his deep concern about the foreclosure epidemic, but also because he has made a compelling recommendation to level an exceedingly tilted playing field in mortgage finance.

Depending upon your perspective, Mr. Miller is either the right man in the right place on Capitol Hill — if you're a consumer — or a threat to the status quo.

A lawyer who worked on consumer protection issues in North Carolina, Mr. Miller is not new to battling banks. In March 2009, along with Representative William D. Delahunt, a Democrat from Massachusetts, he proposed the creation of an independent consumer agency; it became a part of the recent financial overhaul. This past March, Mr. Miller introduced a bill that would eliminate one of the most pernicious conflicts of interest in banking today: the dueling roles played by the big mortgage servicers.

These companies — the biggest are Bank of America, JPMorgan Chase, Wells Fargo and Citibank — operate as the back office for the mortgage lending industry. In good times, their tasks are fairly simple: they take in monthly mortgage payments and distribute them to whoever owns the loans. In many cases, large institutions like pension funds or mutual funds own the mortgages, and servicers are obligated to act in their interests at all times.

When borrowers are defaulting in droves, as they are now, loan servicing becomes much more complex and laborious. Servicers must chase delinquent borrowers for payments and otherwise manage these uneasy relationships, possibly into foreclosure.

So where does the conflict of interest lie? Often, the same bank that services a primary mortgage owned by another institution also owns a second mortgage or home equity line of credit on the same property. When that borrower has trouble meeting both payments, the servicer has an interest in making sure that amounts owed on the second lien, which it owns, continue to be paid even if the first loan, which it has no interest in, slides into delinquency. About two-thirds of primary mortgages are serviced by banks who do not own them but hold the accompanying seconds.

This conflict is a crucial reason that the government's loan modification program has been so woefully ineffective. The Treasury Department never forced the second-lien holders who service troubled primary mortgages to reduce the amount they are owed by borrowers, even though such a move would give them a better shot at keeping their homes.

Of course, the big banks that hold these second liens have little interest in letting borrowers write them off entirely, or in part, because the institutions would have to absorb huge losses on them. As long as the borrower is eking out payments on the second liens, the banks that own them can pretend that they are performing and keep recording them at high values on their books.

The top four banks hold approximately $450 billion in second liens that are supposed to take a backseat to the investors who hold the primary mortgages. But because of the front-seat role big banks play as servicers, they are in a position to put their interests first.

"Unless we can make servicers modify mortgages through bankruptcy or eminent domain, the servicers are not going to reduce principal," Mr. Miller, 57, said in a recent interview. "Their stance does seem largely driven by accounting concerns — they are trying to maintain the fiction that the mortgages are worth the value they are carrying them at on their books."

Enter Mr. Miller's bill, the Mortgage Servicing Conflict of Interest Elimination Act. It bars servicers of first loans they do not own from holding any other mortgages on the same property.

Mr. Miller's bill has not gained much attention since it was introduced in March. But it ought to, because the Dodd-Frank financial overhaul law is utterly silent on servicer conflicts.

The bill would give these institutions a reasonable amount of time to divest either their servicing businesses or their interests in home mortgages, Mr. Miller said. A likely outcome is that the four biggest banks would spin off their mortgage servicing operations. This would not only resolve the conflict between loan servicers and investors, but it would also result in smaller, less complex banks, he said. That is surely a major benefit.

Another is that Mr. Miller's law, if enacted, would break up the logjam now thwarting mortgage modifications. "We must reinvent our mortgage finance system," he said. "This is a huge part of our economy, and we cannot have a healthy recovery with the housing sector as sick as it is."

A member of the House Financial Services Committee, Mr. Miller concedes that he did not see the financial crisis coming. But he said that several years ago he became aware that increasingly poisonous mortgages were being peddled to consumers.

"These mortgages were not designed to increase homeownership; they were designed to trap people in debt and strip the equity in their home as home prices appreciated," Mr. Miller said. "For the financial industry, that increasing wealth from middle-class homeowners was an attractive target; if they could trap families in a cycle of borrowing every three years or so, then a lot of increased wealth in their homes would end up in the financial sector rather than with those families."

Mr. Miller recognizes that his is an uphill climb because the big banks have many friends in high places across Washington. "Americans have come away from this persuaded that everything has been done to help the banks and not to help them," he said. "And in a democracy, that's a real problem."

Still, he said he has recently noted a slight shift in the balance of power. "I've seen the banks going from losing no fights to losing a few fights," he said. "What I've found is the more fights we pick, the more success we have."

Here's to more fights, then. Many more.