

TRUST BANKS IN THE CROSS-HAIRS

Trust banking is boring. Trust bankers like it that way. But that may change, thanks in part to a recent lawsuit filed by the insurance arm of the Catholic fraternal organization The Knights of Columbus (Knights).

At the end of May the Knights filed suit against The Bank of New York Mellon (Mellon), one of the largest trust operations in the world. Mellon was chosen to be the trustee of two large trust pools (Trusts) composed of sub-prime mortgages originated by Countrywide Financial, the now-defunct mortgage lender, purchased by Bank of America.

Another lawsuit related to sub-prime mortgages. Ho-hum. But why sue the trustee holding the assets? The answer is: *information*.

**MONEY IS POWER.
KNOWLEDGE IS POWER.
KNOWLEDGE IS,
THEREFORE, MONEY.**

In this complaint the Knights are not seeking damages against Mellon as trustee (at least not yet). They are simply seeking a detailed accounting of the trust during and since the collapse of the mortgage market. The charity is seeking an

“accounting of: (a) all costs, charges, and expenses for which the Master Servicer has obtained or sought reimbursement from either Trust or from the proceeds of any foreclosure, payment, short sale, or other money received related to a loan in a Trust...”

The Knights assert that the regular accounting statements they receive from Mellon fail to disclose critical information related to the various costs charged back to the Trusts. While the target of the Knights' attempt to recover their losses may ultimately be Bank of America, Mellon is the one in the cross-hairs as the party that potentially has a fiduciary obligation to produce adequate accounting. The Knights argue those accountings will expose



the many alleged errors made by Bank of America² in the servicing of the mortgage pools.

TRUST BANKS STAND AT THE CENTER OF THE SUB-PRIME MESS

This unusual complaint outlines the issues at the very core of the entire mortgage buyback controversy, including 'robo-signing' and undocumented foreclosures. These issues became relevant to the Knights because the legal fees and other costs associated with the enforcement of these allegedly sloppy foreclosures may have been billed back to the Trusts and ultimately to investors.

Other expenses associated with maintaining foreclosed properties, such as lender or forced placed insurance, are also generally charged back to the trust and, in the end, the investors. In the case of Bank of America, the

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broker placing much of its insurance on the foreclosed properties was Balboa Insurance, then a subsidiary of the bank. The Knights would like to see an accounting of the fees that Bank of America was charging the trust through its subsidiary Balboa. The complaint even argues that

"force-placed insurance has helped make drawn-out foreclosures lucrative for servicers..."³

Clearly the Knights are going to a lot of trouble to gain access to the data. There can be no doubt that their goal is to accumulate the necessary evidence to bring a successful claim against Bank of America and seek to recoup some of the losses and charges incurred by the Trusts.

TRUST BANKS: INNOCENT BYSTANDERS NO LONGER

The Knights do not state whether they believe that Mellon has this data, simply that as trustee they have a duty to provide a thorough accounting of all costs – including litigation costs and insurance fees.

As part of their 'books and records' demand, the Knights hope to gain insight on how Bank of America was servicing the assets of the Trusts asking Mellon to provide information on

"the practices of the Master Servicer related to foreclosures and REO Property..."⁴

Once armed with the data and insight, will the Knights pursue the servicer and excuse the trustee or will they later claim that by allowing the charges to the trust that the trustee failed in their fiduciary duties?

WHO PAYS?

Producing detailed accounting and analysis on the massive mortgage pools will be an expensive task even for a large and efficient operation like Mellon.

The Knights' complaint asks the court to assign the cost to

"any party found to have unjustly caused the Trusts to incur losses or expenses, and second, if that is not possible, against the parties receiving the benefit..."⁵

The fundamental question at hand remains: is a trust liable for the cost or will its insurance cover such cost? Did Mellon, in the words of the Knights, cause "the Trusts to incur losses?" As in all coverage discussions, one must review each contract individually as terms and conditions vary, first looking to see if there is a "claim" as defined by the relevant policy. The Knights have made a legal demand against Mellon as a result of a professional relationship; therefore, a professional liability or Errors & Omissions (E&O) policy would be the place to start.

The threshold question is: does the legal demand include an allegation of a Wrongful Act as defined in the Trust’s E&O policy? The complaint itself is rife with allegations, both specific and general, against the Master Servicer and asserts that the Defendant has done nothing to bring this wrong doer to book:

“Defendant has taken no action with respect to any material noncompliance identified, or any of the other allegations described in this Complaint.”⁶

These allegations against the servicer include the findings of critical deficiencies and shortcomings from a review done by the Office of Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation and the Federal Reserve Board of the foreclosure processing at the nation’s 14 largest federally regulated mortgage servicers, including the Master Servicer.

Depending on the specific E&O policy, such deficiencies might be sufficient to trigger coverage where the claim includes written demands or suits seeking monetary or non-monetary relief. Alternatively, the Knights’ suit here might be a circumstance that could foreseeably lead to future claims; generally, one is permitted, but not required, to provide notice of such actions. But keep a critical eye on whether or not this legal action might trigger a ‘prior knowledge’ exclusion if not reported to the insurer.

Such requests for records rarely result in complaints against trust banks. With the wave of suits involving trusts and securitized assets – there may be more on the way.

ANYTHING BUT BORING

When the notorious bank robber Willie Sutton was asked why he robbed banks, he famously answered “*because that’s where the money is.*” When we ask why sue trust banks, the answer will now be clear – that’s where the information is.

Trust banking may not be so boring in the future.

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The observations, comments and suggestions we have made in this publication are advisory and are not intended nor should they be taken as legal or financial advice. Please contact your own legal or financial adviser for an analysis of your specific facts and circumstances.

¹ Complaint, *Knights of Columbus v. The Bank of New York Mellon*, No. 651442/2011, (Supreme Court of the State of New York, County of New York, 2011).

² “Recent revelations from a variety of credible sources indicate that the Master Servicer may be acting for its own benefit rather than for the benefit of investors. Furthermore, the acts detailed below indicate that the Master Servicer may be damaging the borrowers whose loans make up each Trust’s corpus...” Id at #19, page 7.

³ Id at #74, page 25.

⁴ Id at #88, page 28.

⁵ Id at page 28.

⁶ Id at #22, page 8.

⁷ Id at #22 and 23, page 8.