

# ON THE MONEY

## The robo-signing deal: A useless embarrassment



ISTOCK



Barry Ritholtz  
ON INVESTING

After many months of wrangling, a foreclosure settlement has been reached between 49 state attorneys general and a consortium of banks.

It is an epic failure of law and a triumph for bank

attorneys.

It will accomplish little of value, as I'll explain. First, let's recall what the "robo-signing" foreclosure scandal was all about.

Foreclosure is an extremely serious issue in American jurisprudence. As a nation of laws with strong respect for property rights, we have always treated this process appropriately. After all, having a sheriff forcibly evict a family that typically made a down payment, moved into a home, lived there for some years, made payments, etc., is disruptive — for the family, the lender and the neighborhood.

Foreclosure laws vary from state to state. However, all are specific and precise as to the legal steps that must be followed, from the homeowner's initial delin-

quency onward. There are benefits to giving the homeowner a chance to "cure their default." It is in everyone's interest for the homeowner to catch up if possible.

We never want to see an innocent party "accidentally" evicted from a home. The legal system has evolved so this has become a "legal impossibility." Imagine returning home from work or vacation to find the front door padlocked, the belongings strewn all over the block, a big orange sticker screaming "FORECLOSED" on the garage door, with an auction sign in the front lawn. Now imagine that this occurred even though you are not in default or even delinquent on payments. Thanks to the robo-signing banks, this legal impossibility has happened repeatedly, even to homeowners who paid cash for their houses and had no mortgages. Imagine that — foreclosed with no mortgage.

Before any foreclosure can proceed, a lender must run through a checklist of specifics for the court to move forward. This review can take 45 to 120 minutes per file and addresses, for instance:

- When was the original loan

made, and for how much?

- Who is the borrower? Who is the original lender?

- What is the address of the property?

- Which bank holds the mortgage note? Was the note transferred? When?

- When was the last payment made?

- How much is owed on the loan?

- Was the borrower notified of the delinquency? Default?

- Has the borrower been served notice? When, where and how?

Banks review these details to make sure there was not an administrative error. (Oops! We applied payments to wrong account!) The banker who reviewed these files fills out and signs an affidavit, which is then notarized. It is the written equivalent of sworn testimony in court. Judges take affidavits extremely seriously. False affidavits bypass the entire fact-finding and legal process, and the result can be a miscarriage of justice. Anyone who lies on one commits perjury, a felony punishable by jail time. At least, they used to get jail

time.

Before the settlement, we learned that nearly every aspect of the robo-signed documents was false. None of the details were ever reviewed. The signatures attesting to the review of the documents were fabricated — made by someone other than the person whose name was on the document. Neither person — the supposed signatory to the document nor the hired forger — ever validated the facts of each case. All of the safeguards put in place to make sure foreclosures were done correctly and legally were bypassed. Even the notary stamps were bogus — they were not real, and not signed by a notary to validate that the signer and the signature matched.

How did this happen? Instead of a careful review, people were hired to rubber-stamp hundreds of foreclosure documents an hour. Former burger flippers were paid \$8 to \$10 an hour to violate the law, file false affidavits and commit perjury. Some of the information was correct, but much of it was wrong — and none of it was verified for court purposes.

And now we have this grand settlement.

What will the impact be?

Economically, it will have no effect. The dollar amount is small relative to the U.S. economy. Indeed, the total impact of the settlement is less than one ten-thousandth of annual gross domestic product.

Then there's the "math." The number touted is \$26 billion, but that's wildly misleading. At most, it's \$6 billion, paid out by a consortium of banks. The other \$20 billion is for capital write-downs for delinquent homeowners that were going to happen anyway. These were homes that the banks anticipated taking a \$50 billion-to-\$100 billion hit on. Only now, they get a tax benefit for it.

As far as the U.S. housing market goes, the impact will be minimal. About one out of five mortgages are underwater — meaning the house is worth less than is owed on it. Today, more than 11 million mortgages are underwater.

The settlement won't affect the majority of these homes. Depending on which analysis you believe, the borrowers who receive a principle write-down will get \$2,000 to \$20,000 off their mortgage. This will not appreciably change the situation for most borrowers. They owe many tens of thousands more than the house is worth; some are hundreds of thousands of dollars behind in payments. Most will be as likely to default after this write-down as before. The impact on the overall underwater-mortgage issue is almost nonexistent.

The bigger issue is the economics of criminality. Most people who get caught committing crimes are punished. Commit a felony — if you run a bank — and your shareholders pay a monetary fine. Violating the law has merely become the banker's cost of doing business.

Thus, the robo-signing agreement has allowed the mass production of perjury. It has gone unrecognized and unpunished. It has made perjury a business expense, like travel or office furniture. The same reckless approach to giving loans to unqualified people was institutionalized, leading to another reckless approach to foreclosing homes.

We still don't know who ordered these crimes, who is responsible for this, whether they still are in their jobs — or whether they are in a position of authority to do the same thing again.

Last, politically, the settlement reveals the corrupting influence of bank bailouts. Government is supposed to enforce laws equally and fairly. Instead, it is protecting its investments in rogue banks. They are committed to their original error and are loath to admit it. This is the reason that after a surgical accident, a new surgeon does the repair. He is objective and has nothing to hide. Conflicted governments, though, are focused on their reputation and re-election.

The robo-signing agreement will serve as an exemplar to future generations of what *not* to do when confronted with failing banks.

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STEVEN PEARLSTEIN

## Manufacturing revival begins with entrepreneurs

PEARLSTEIN FROM GI

see what any smart entrepreneurs would see — a bunch of experienced and committed workers who were anxious for a job, along with vacant facilities and unused machinery that could probably be acquired for a song. In other words, he and his colleagues saw a good business opportunity, and they took it.

Today, Springboard Engineering employs about 65 engineers and support staff in what used to be an old Kmart and an old Wal-Mart across from each other on Highway 6. They are helping nearly all of the world's major appliance makers to develop, prototype and test new products. And they are branching out into home furnishings and consumer electronics. The company was profitable and promising enough last year that it was bought by Underwriters Laboratories, whose Good Housekeeping seal of approval sets the industry standards for reliability and safety. With UL's reputation, capital and client list, Springboard is about to go global in a serious way. Today there are openings for eight employees.

Success was hardly guaranteed. Although Whirlpool was willing to give Bruntz a running start by selling him equipment and sending work his way, it took a lot of looking to find even one local bank willing to provide the needed start-up capital. The town of Newton offered some tax relief, and the state of Iowa stepped in with a low-cost loan.

But perhaps the greatest hurdle was getting a bunch of engineers comfortable with the risks associated with going out on their own.

Bruntz recalls making a presentation to the first meeting of the employee-directors to show that, if things broke their way, they would have enough business to keep busy for six months. At the next monthly meeting, the report was nearly the same: six months of work, but nothing beyond.

"It took a few more months of the same report before it dawned on us that this was what it meant to be in business for ourselves," Bruntz said.

Springboard is hardly unique. There are hundreds of examples of laid-off workers who gave up waiting for someone else to come along and give them jobs and created their own jobs instead.

The most common model is when a plant executive or department manager like Bruntz — someone with business savvy and experience — takes the lead in raising the outside capital and striking a deal with the old company.

In other cases, it's the employees themselves who provide much of the equity capital and own the company, often through a tax-advantaged employee stock option plan. Perhaps the most celebrated is Springfield ReManufacturing, which under the leadership of Jack Stack took a division of the failing International Harvester and transformed it into a multibillion-dollar enterprise in which every employee is encouraged to look in on the company's financial statements and operating results. Stark's "open-book management" has a cult following in the entrepreneurial community.

These days, there are even a handful of private-equity firms, such as South Franklin Street Partners in Cleveland and KPS Equity in New York, that specialize in manufacturing-sector buyouts with significant levels of employee involvement and risk-sharing.

If there is going to be a genuine manufacturing revival in the United States, however, my guess is that there will have to be many more Springboards and Springboards. It's encouraging that companies such as General Electric and Master Lock are bringing high-value, high-wage work back to American plants. But if we have learned anything in the past two decades, it is that we can't rely on the goodwill of global executives who are

slaves to the latest management fad and loyal to no one other than their shareholders. Any revival of manufacturing needs to begin with entrepreneurial self-reliance.

Ohio has been a pioneer in this area with the Employee Ownership Center at Kent State University, which helps workers and managers put the pieces together for new employee-owned enterprises. This is often an exercise that founders on wishful thinking, and the center has a list of experienced advisers who help weed out unrealistic business plans while helping the good ones become reality. It's a relatively inexpensive model that other states should explore.

The second hurdle is finding capital for the good ideas, made all the more difficult these days because so many banks have lost the knack or the appetite for making anything other than asset-based loans to established firms. That's particularly true when employee ownership is

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involved. Federal bank regulators could certainly provide banks fewer disincentives than they now do for this kind of lending. If that doesn't work, Sens. Sherrod Brown (D-Ohio) and Bernard Sanders (I-Vt.) have a proposal for partial federal guarantees of bank loans to employee-sponsored start-ups that might catch the bankers' attention.

One final problem is resistance from the companies that have decided to shut down a plant but don't particularly relish the prospect of competition from former employees who know their products, customers and processes. This can take the form of locking up old facilities and equipment, forcing exclusive contracts onto suppliers and distributors, and demanding noncompete agreements as a condition for severance payments. By outlawing such noncompete clauses and making judicious use of antitrust and eminent-domain powers, states could be a lot more aggressive in discouraging this anticompetitive behavior.

When the Brookings Institution issued its blueprint for a manufacturing revival this month, it was noteworthy that one of its four key recommendations was for "an increased role for workers and communities in creating and sharing the gains from innovative manufacturing." Germany provides the model for how a high-wage country can still have a globally competitive manufacturing sector, and like most others who have studied it, the Brookings researchers found that employee involvement and gains-sharing is a key to that success. It's also true here: The data are pretty clear that companies that have some level of employee-ownership have higher productivity and profitability than those that don't.

The best way to revive American manufacturing isn't to add yet another loophole to the corporate tax code, the latest lame proposal from the Obama economic team. It's to reach beyond Wall Street and the corporate mind-set and tap into the ingenuity and the entrepreneurial instincts of the American worker.

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