



SFA Case Summary:
Powell v. Ocwen Financial Corporation

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The plaintiffs in *Powell v Ocwen* are attempting to challenge a deal sponsor's debt characterization of RMBS investment grade rated securities for ERISA purposes as well as claiming the Trustees are fiduciaries under ERISA – a ruling in their favor would lead to significant negative impact to the market and therefore the underlying consumers and businesses our market supports

Background

This case highlights the importance of the long-standing fundamental market assumption regarding “plan asset” analysis and which securitization transaction parties are fiduciaries under ERISA – and its impact on the securitization market. The plaintiffs in *Powell v Ocwen* are attempting to challenge a deal sponsor's debt characterization of RMBS investment grade rated securities for ERISA purposes, which if successful could result in the securitization vehicle being considered plan assets under ERISA. The plaintiffs also argue that the court should hold for the first time that loan servicer and master servicer of a securitization trust be considered ERISA fiduciaries with fiduciary liability under ERISA. **While expert market participants and counsel alike believe such a ruling is unlikely, this case is very important given the potentially significant negative impact on the market and therefore the underlying consumers and businesses our market supports.**

Case Details

The plaintiffs (trustees of a United Food Commercial Workers pension plan, or “Plan”) filed a complaint against the Defendants, including Ocwen, Wells Fargo, and others service providers in connection with investments made by the Plan in notes (the “Notes”) issued by two American Home Mortgage Investment Corporation Trusts (the “Trusts”) in 2004 and 2005. The underlying assets of the Trust were residential mortgages.

The plaintiffs **incorrectly** assert that:

1. The Notes purchased from these two RMBS Trusts should be treated as equity interests for ERISA purposes;
2. As a result, based on the ERISA status of the investors that acquired the Notes, the Trusts' assets should then be recognized as plan assets subject to ERISA;

3. Ocwen (and Wells Fargo) as servicer should be considered fiduciaries given the Trusts' assets are plan assets and both entities also satisfy the fiduciary definition in Sec 3(21) or ERISA; and
4. The Plan therefore can assert ERISA-related claims against the Trusts' servicers (the "Servicers"), including Ocwen and, in the case of the 2005 Trust, Wells Fargo in its capacity as master servicer.

Key points with respect to the Notes at issue in the case:

- The offering documents for the two deals indicate that the Notes were treated as debt¹ for purposes of ERISA, and investors were deemed to represent as to the debt status of the Notes when investing in the deal.
- Each of the Notes had an investment grade rating at the time of the offering.
- Tax counsel to the deals issued a "will be debt" tax opinion with respect to the relevant classes of Notes.
- Each of the Trusts also issued certificates, which were treated as equity, and those certificates were restricted to avoid the issuers becoming subject to ERISA.

Despite the foregoing, the plaintiffs argued that they had an equity interest in each Trust – specifically that they had a beneficial ownership interest in each Trust. Taking such position, the Plaintiffs then argued that the assets of each Trust (the mortgages) were "plan assets" of the Plan, and that Ocwen and Wells Fargo (with respect to the 2005 Trust) were fiduciaries to the Plan and had engaged in violations of ERISA.

Court Actions, Status and Timing

This case is in the US District court for the Southern District of New York.

- The court indicated that for the plaintiffs to prevail, they would have to demonstrate that two conditions are satisfied: (1) that the assets of each Trust constitute "plan assets" under ERISA and (2) that Ocwen qualifies as a fiduciary to the Plan.
 - In Ocwen, the plaintiffs argued that the Plan held a beneficial ownership interest (amounting to an equity interest) in each Trust and that Ocwen "exercised sweeping, unchecked control of the management and disposition of the mortgages and was thus a fiduciary".

- However, Ocwen and Wells Fargo filed numerous exhibits in connection with their motions to dismiss the action, which the court said cast considerable doubt on the ability of the plaintiffs to support their allegations.
- The court determined that certain of the materials submitted by Ocwen and Wells Fargo (including the tax opinion letters) were outside the bounds of what the court could consider as part of a motion to dismiss.
- The court noted that it believed that these documents may shed light on the threshold factual questions at issue, and exercised its discretion to convert Ocwen’s and Wells Fargo’s motions to dismiss into motions for summary judgment so that the judge could consider the additional materials submitted by Ocwen and Wells Fargo
- The judge granted the parties additional time - motions are now due December 9.
- SFA has engaged counsel and will file an amicus brief by the due date of December 16.

Rationale for SFA to file an amicus brief

- Plaintiffs argue that a security that was classified as, considered to be, and treated as a debt instrument, should be treated instead as equity (after the fact) for purposes of ERISA.
- Many structured finance deals are structured as “debt” deals where pension plans can buy certain classes of Notes subject to making certain deemed ERISA representations.
- If, however, the investment grade rated securities issued in a structured finance transaction are treated as equity for purposes of ERISA, as a general matter either 1) the securities will be ERISA restricted, or 2) the transaction will need to comply with certain special DOL exemptions known as the “Underwriter Exemptions” (which are commonly used in CMBS transactions).
- If this matter is decided in favor of the plaintiffs, this would upend long-standing fundamental market assumptions and could have significant repercussions for the structured finance market.

ⁱ Relevant U.S. Department of Labor (“DOL”) regulations provide that an interest will be treated as an equity interest in an entity other than an instrument that is treated as indebtedness under local law and which has no substantial equity features. The DOL regulations give examples of equity interests, including a beneficial interest in a trust.

SFA Contact Information

Kristi Leo
President
kristi.leo@structuredfinance.org
917.415.8999

Jennifer Wolfe
Director, ABS and Investor Policy
jennifer.wolfe@structuredfinance.org
202.524.6312