Statement of:

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Foreclosed Justice: Causes and Effects of the Foreclosure Crisis

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Chairman Conyers, Ranking Member Smith, Members of the Committee, my name is Tom Deutsch and as the Executive Director of the American Securitization Forum, I appreciate the opportunity to testify here today on behalf of the 330 ASF member institutions who originate the collateral, structure the transactions, serve as trustees, trade the bonds, service the loans and invest the capital in the preponderance of residential mortgage- and asset-backed securities ("RMBS") and ("ABS") in the United States, including those backed entirely by private capital as well as those guaranteed by Ginnie Mae and the government sponsored enterprises ("GSEs") such as Fannie Mae and Freddie Mac.

In this testimony, we seek first to highlight some of the key aspects of securitization as well as its importance to the U.S. and global economy. Subsequently, we seek to address the concerns raised by a few commentators that the banking and housing markets may be subject to additional systemic risk because securitization trusts may not actually own the trillions of dollars of mortgages that are supposed to be contained within those trusts. In addition to introducing the white paper that ASF issued two weeks ago, we also examine a number of the new concerns that have been raised since the introduction of that white paper. In particular, we discuss and provide detailed background for four key components of valid loan transfers, including:

A. PSAs meet the requirement for a "complete" or "unbroken" chain of indorsement[1];
B. securitization trusts comply with New York trust law;
C. RMBS trusts effectively achieve REMIC status; and
D. mistakes do not affect validity of transfer.

[1] Note that the Uniform Commercial Code replaces the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this testimony for consistency.

Ultimately, we find that the conventional process for loan transfers embodied in standard legal documentation for mortgage securitizations has been adequate and appropriate to transfer ownership of mortgage loans to the securitization trusts in accordance with applicable law and contract. Since loan transfers have generally been effective, all of the dire consequences that a few commentators have speculated on fade away, given the faulty premise that they start from. Moreover, a number of the concerns that have been raised that securitization professionals have uniformly opted out of use of laws such as the Uniform Commercial Code ("UCC") to set a higher bar for transfers, but then subsequently and systematically failed to meet that higher bar, appear on their face to be illogical assertions and patently false.

I. Role and Importance of Securitization to the Financial System and U.S. Economy

Securitization—generally speaking, the process of pooling and financing consumer and business assets in the capital markets by issuing securities, the payment on which depends primarily on the performance of those underlying assets—plays an essential role in the financial system and the broader U.S. economy. Over the past 40 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses alike.

In recent years, the role that securitization has assumed in providing both consumers and businesses with credit is striking: currently, there is over $12 trillion of outstanding securitized assets, including RMBS, ABS and asset-backed commercial paper ("ABCP"). This represents a market nearly double the normal size of all outstanding marketable U.S. Treasury securities—

bonds, bills, notes, and TIPS combined.[2] Between 1990 and 2006, issuance of MBS grew at an annually compounded rate of 13%, from $259 billion to $2 trillion a year.[3] In the same time period, issuance of ABS secured by auto loans, credit cards, home equity loans, equipment loans, student loans and other assets, grew from $43 billion to $753 billion. In 2006, just before the downturn, nearly $2.9 trillion in RMBS and ABS were issued. As these data demonstrate, securitization is clearly an important sector of today's financial markets.

The importance of securitization becomes more evident by observing the significant proportion of consumer credit it has financed in the U.S. It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 59% of outstanding home mortgages.[4] Securitization plays a critical role in non-mortgage consumer credit as well. Historically, banks securitized 50-60% of their credit card assets.[5] Meanwhile, in the auto industry, a substantial portion of automobile sales are financed through auto ABS.[6] Overall, recent data collected by the Federal Reserve Board show that securitization has provided over 25% of outstanding U.S. consumer credit.[7] Securitization also provides an important source of commercial mortgage loan financing throughout the U.S., through the issuance of commercial mortgage-backed securities ("CMBS").

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[2] U.S. Department of the Treasury, "Monthly Statement of the Public Debt of the United States: August 31, 2009," (August 2009). < http://www.treasurydirect.gov/govt/reports/pd/mspd/2009/opds082009.pdf>.
[3] National Economic Research Associates, Inc. (NERA), "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," pg. 16 (June 2009). <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf >.
[4] Citigroup, "Does the World Need Securitization?" pg. 10-11 (Dec. 2008). <http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf>.
[5] Ibid., pg. 10.
[6] Ibid., pg. 10.
[7] Federal Reserve Board of Governors, "G19: Consumer Credit," (September 2009). <http://www.federalreserve.gov/releases/g19/current/g19.htm>.

Over the years, securitization has grown in large measure because of the benefits and value it delivers to transaction participants and to the financial system. Among these benefits and value are the following:

1. *Efficiency and Cost of Financing.* By linking financing terms to the performance of a discrete asset or pool of assets, rather than to the future profitability or claims-paying potential of an operating company, securitization often provides a cheaper and more efficient form of financing than other types of equity or debt financing.

2. *Incremental Credit Creation.* By enabling capital to be recycled via securitization, lenders can obtain additional funding from the capital markets that can be used to support incremental credit creation. In contrast, loans that are made and held in a financial institution's portfolio occupy that capital until the loans are repaid.

3. *Credit Cost Reduction.* The economic efficiencies and increased liquidity available from securitization can serve to lower the cost of credit to consumers. Several academic studies have demonstrated this result. A recent study by National Economic Research Associates, Inc., concluded that securitization lowers the cost of consumer credit, reducing yield spreads across a range of products including residential mortgages, credit card receivables and automobile loans.[8]

4. *Liquidity Creation.* Securitization often offers issuers an alternative and cheaper form of financing than is available from traditional bank lending, or debt or equity financing. As

[8] National Economic Research Associates, Inc. (NERA), "Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets," (June 2009), pg. 16. <http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf>.

a result, securitization serves as an alternative and complementary form of liquidity creation within the capital markets and primary lending markets.

5. *Risk Transfer.* Securitization allows entities that originate credit risk to transfer that risk to other parties throughout the financial markets, thereby allocating that risk to parties willing to assume it.

6. *Customized Financing and Investment Products.* Securitization allows for precise and customized creation of financing and investment products tailored to the specific needs of both issuers and investors. For example, issuers can tailor securitization structures to meet their capital needs and preferences and diversify their sources of financing and liquidity. Investors can tailor securitized products to meet their specific credit, duration, diversification and other investment objectives.[9]

Recognizing these and other benefits, policymakers globally have taken steps to help encourage and facilitate the recovery of securitization activity. The G-7 finance ministers, representing the world's largest economies, declared that "the current situation calls for urgent and exceptional action…to restart the secondary markets for mortgages and other securitized assets."[10] The Department of the Treasury stated in March, 2009 that "while the intricacies of secondary markets and securitization…may be complex, these loans account for almost half of

[9] The vast majority of investors in the securitization market are institutional investors, including banks, insurance companies, mutual funds, money market funds, pension funds, hedge funds and other large pools of capital. Although these direct market participants are institutions, many of them—pension funds, mutual funds and insurance companies, in particular—invest on behalf of individuals, in addition to other account holders.
[10] G-7 Finance Ministers and Central Bank Governors Plan of Action (Oct. 10, 2008). <http://www.treas.gov/press/releases/hp1195.htm>.

the credit going to Main Street,"[11] underscoring the critical nature of securitization in today's economy. The Chairman of the Federal Reserve Board noted that securitization "provides originators much wider sources of funding than they could obtain through conventional sources, such as retail deposits" and also that "it substantially reduces the originator's exposure to interest rate, credit, prepayment, and other risks."[12] Echoing that statement, Federal Reserve Board Governor Elizabeth Duke stated that the "financial system has become dependent upon securitization as an important intermediation tool,"[13] and the International Monetary Fund (IMF) noted in its *Global Financial Stability Report* that "restarting private-label securitization markets, especially in the United States, is critical to limiting the fallout from the credit crisis and to the withdrawal of central bank and government interventions."[14] There is clear recognition in the official sector of the importance of the securitization process and the access to financing that it provides lenders, and of its importance to the availability of credit that ultimately flows to consumers, businesses and the real economy.

Restoration of function and confidence to the securitization markets is a particularly urgent need, in light of capital and liquidity constraints currently confronting financial institutions and markets globally. As mentioned above, at present nearly $12 trillion in U.S. assets are funded via securitization. With the process of bank de-leveraging and balance sheet

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[11] U.S. Department of the Treasury, "Road to Stability: Consumer & Business Lending Initiative," (March 2009). <http://www.financialstability.gov/roadtostability/lendinginitiative.html>.
[12] Bernanke, Ben S., "Speech at the UC Berkeley/UCLA Symposium: The Mortgage Meltdown, the Economy, and Public Policy, Berkeley, California." *Board of Governors of the Federal Reserve System* (Oct. 2008). <http://www.federalreserve.gov/newsevents/speech/bernanke20081031a.htm>.
[13] Duke, Elizabeth A., "Speech at the AICPA National Conference on Banks and Savings Institutions, Washington, D.C." *Board of Governors of the Federal Reserve System* (Sept. 2009). <http://www.federalreserve.gov/newsevents/speech/duke20090914a.htm>.
[14] International Monetary Fund, "Restarting Securitization Markets: Policy Proposals and Pitfalls." *Global Financial Stability Report: Navigating the Financial Challenges Ahead* (Oct. 2009), pg.33. <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.

reduction still underway, and with increased bank capital requirements on the horizon, such as those expected in Basel III, the funding capacity provided by securitization cannot be replaced with deposit-based financing alone in the current or foreseeable economic environment. In fact, the IMF estimated that a financing "gap" of $440 billion existed between total U.S. credit capacity available for the nonfinancial sector and U.S. total credit demand from that sector for the year 2009.[15] Moreover, non-bank finance companies, who have played an important role in providing financing to consumers and small businesses, are particularly reliant on securitization to fund their lending activities, since they do not have access to deposit-based funding. Small businesses, who employ approximately 50% of the nation's workforce, depend on securitization to supply credit that is used to pay employees, finance inventory and investment, and other business purposes. Furthermore, many jobs are made possible by securitization. For example, a lack of financing for mortgages hampers the housing industry; likewise, constriction of trade receivable financing can adversely affect employment opportunities in the manufacturing sector. To jump start the engine of growth and jobs, securitization is needed to help restore credit availability.

Simply put, the absence of a properly functioning securitization market, and the funding and liquidity this market has historically provided, adversely impacts consumers, businesses, financial markets and the broader economy. The recovery and restoration of confidence in securitization is therefore a necessary ingredient for economic growth to resume, and for that growth to continue on a sustained basis into the future.

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[15] International Monetary Fund, "The Road to Recovery." *Global Financial Stability Report: Navigating the Financial Challenges Ahead* (Oct. 2009), pg. 29. <http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf>.

II. Transfers of Loans into the Secondary Mortgage Market

By way of background, there are approximately 55 million first lien mortgages outstanding in the United States today and an additional 25 million homes that have no mortgage attached to them. The debt outstanding for these 55 million mortgages is nearly $9.75 trillion dollars, of which approximately $7 trillion dollars resides in securitization trusts and are beneficially owned by institutional investors around the world. Approximately $5.5 trillion dollars of these loans are government guaranteed in Ginnie Mae and GSE RMBS, with an additional $1.5 trillion in outstanding private-label RMBS that has no government backstop. An additional $2.75 trillion dollars of mortgage debt is owned in the portfolios of commercial banks, savings institutions and insurance companies. In addition to the $9.75 trillion of outstanding first lien mortgages, approximately $1 trillion of second liens are currently outstanding in the United States.[16]

As part of the larger public discourse about the current state of the residential mortgage market and the increasing number of foreclosures in America, a surprising number of concerns have been raised in the last couple of months in the midst of the worst housing crisis since the Great Depression that question whether the common legal procedures that have been used to transfer residential mortgage loans into RMBS trusts were in fact legally valid. A number of different dire outcomes have been raised if loans weren't validly transferred, including borrower confusion as to who to pay their mortgage to, large bank losses, and further housing market

[16] Data compiled by Amherst Securities, based on information from the Federal Reserve Flow of Funds, Fannie Mae, Freddie Mac, Ginnie Mae and CoreLogic.

turmoil. A recent Congressional Oversight Panel Report ("COP Report")[17] has even suggested that these issues could create systemic risk concerns if loans weren't appropriately assigned to securitization trusts.

But the key incorrect premise that each of these dire outcomes relies upon is that the $7 trillion dollars of outstanding securitized mortgage debt has not in fact been systematically transferred in a legally sound manner. ASF believes these concerns are without merit and our membership is confident that these methods of transfer are sound and based on a well-established body of law governing the multi-trillion dollar secondary mortgage market. The conventional process for loan transfers embodied in standard legal documentation for mortgage securitizations has been adequate and appropriate to transfer ownership of mortgage loans to the securitization trusts in accordance with applicable law. This process is sufficient to establish ownership by the securitization trusts. Moreover the concerns that have been raised have not been supported by substantiation that there are in fact any material signs of systematic fails in the system. Indeed, the origin of these concerns is not clear: they are not the result of a series of court cases supporting the arguments advanced and appear to be largely the result of academic theories. In fact, even the COP Report states that "the Panel takes no position on whether any of these arguments are valid or likely to succeed."[18]

As part of our members' diligence into these public concerns, the ASF issued two weeks ago a white paper legal study entitled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market" (the "ASF White Paper"), which is attached to this

[17] Congressional Oversight Panel, *November Oversight Report, Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation* (November 16, 2010) <http://cop.senate.gov/documents/cop-111610-report.pdf>.
[18] Ibid., pg. 25, footnote 75.

testimony as Attachment A. In the White Paper, the ASF exhaustively studied traditional legal principles and processes, including common law, the Uniform Commercial Code and substantial case history, and finds that traditional legal principles and processes, including the not codified common law rule that "the mortgage follows the note," are fully consistent with today's complex holding, assignment and transfer methods for mortgage loans, which are legally effective for participants in the secondary mortgage market to transfer mortgage loans. Thirteen major U.S. law firms noted in Exhibit A to the ASF White Paper reviewed the ASF White Paper and believe that the Executive Summary contained therein represents a fair summary of the legal principles presented. Although we believe the ASF White Paper answered a number of the concerns that had previously been raised, some new concerns have been raised since the ASF White Paper has been published. In this testimony, we address four of these new concerns.

A. PSAs Meet the Requirement for a "Complete" or "Unbroken" Chain of Indorsement

In testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs on November 16, 2010,[19] Mr. Adam J. Levitin, Associate Professor of Law at Georgetown University Law Center, commented that while he did not disagree with the statements in the ASF White Paper about how mortgage loans may be legally transferred pursuant to contract law and the UCC, he believes that the ASF White Paper does not address some additional arguments as to why mortgage loans might not have been legally transferred to RMBS trusts in many cases.

[19] Testimony of Professor Adam J. Levitin, U.S. Senate Committee on Banking, Housing and Urban Affairs Hearing, November 16, 2010.
http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a

These arguments are outlined in Mr. Levitin's testimony submitted to the Senate Committee for these hearings, and further in testimony submitted to the House Financial Services Committee, Subcommittee on Housing and Social Opportunity, on November 18, 2010.[20] We seek to address these concerns directly herein.

In his written testimony as well as his statements before the Senate Committee, Mr. Levitin does not rely on the decisions in any court cases but instead discusses standard provisions of documentation typically used to issue RMBS, which generally is in the form of a pooling and servicing agreement ("PSA"). A typical PSA includes a section requiring that legal documents for each pooled mortgage loan be delivered to the trustee, or to a custodian on the trustee's behalf. This provision typically requires delivery of the original mortgage note, which must bear the following indorsements: 1) either an indorsement in blank or an indorsement to the trustee, and 2) a 'complete' or 'unbroken' chain of indorsements from the originator or named payee to the person signing the indorsement in blank or to the trustee. The language does not specify who must sign the indorsement in 1). The language used in these typical provisions in any PSA uses either the word "complete" or "unbroken", with no apparent difference in intended meaning from deal to deal. The typical language does not state, nor does it imply, that a "complete" or "unbroken" chain means that all prior owners or holders of the note must appear as part of the chain. Nor does any judicial proceeding consider or uphold this novel opinion. Nor does Professor Levitin provide any third-party support for his interpretation of a typical PSA.

[20] Testimony of Professor Adam J. Levitin, House Financial Services Committee, Subcommittee on Housing and Social Opportunity Hearing, November 18, 2010 <http://financialservices.house.gov/Media/file/hearings/111/Levitin111810.pdf >.

In his testimony, Mr. Levitin suggests, but without providing any source of authority for his interpretation of contractual intent, that the typical PSA requirement for a "complete" chain of indorsements was intended to mean that there must be a separate indorsement from each and every person who was a prior owner of the note, including the originator, the securitization sponsor and the depositor. From his interpretation flows a number of seemingly logical but progressively more dire consequences, including:

i. the PSA was intended to supersede standard indorsement practice as codified in the UCC;
ii. the parties universally failed to comply with this requirement to show an expanded chain of indorsements;
iii. such failure violates the express terms of the PSA and therefore applicable trust law requires that transfers of the mortgage loans to the trust are void;
iv. therefore the trusts don't really own anything and the trusts furthermore violate REMIC requirements;
v. as a result the banks that sold the loans really still own them; and
vi. the banks must repay all investors in full.

All of these consequences flow, however, from a single mistaken core premise—that the typical PSA requirement for indorsements requires this expanded chain. As discussed below, this core premise is incorrect, and therefore the consequences of this premise do not follow.

The typical PSA requirement for a complete or unbroken chain of indorsements to the person signing the indorsement in blank means only that there be no gaps in the chain of indorsements, and that the chain of indorsements be sufficient to effect a transfer to the trust under applicable law. This provision would be interpreted in light of applicable law as well as customary indorsement practice, and the intent of the parties as evidenced by their contemporaneous conduct, all of which support the industry custom reading of a "complete" or "unbroken" chain.

As is clear in the ASF White Paper, for mortgage notes that are negotiable instruments, transfer may be made by negotiation in accordance with UCC Article 3, which requires an indorsement. Once a negotiable mortgage note has been endorsed in blank, negotiation may be effected by transfer of possession alone, until an indorsement has been made or completed in the name of a specific person. In other words, if there is an indorsement in blank, the note may be transferred to numerous successive parties without any need for a separate indorsement to each purchaser. Sales of mortgage notes may also be made pursuant to UCC Article 9, and such a sale is automatically perfected (without delivery of any mortgage note and with no requirement relating to any indorsement) as long as value is given in accordance with an agreement that specifies the mortgage loan to be conveyed, such as a loan schedule to a PSA.

In interpreting the typical PSA requirement for indorsements, we note that this requirement appears in the section that relates to transfer and delivery of the mortgage loans to the trustee. In this context, a "complete" or "unbroken" chain of indorsements is satisfied if the indorsements are sufficient to transfer all rights in and to the mortgage notes to the trustee under applicable law. Thus, for example, where the note was initially payable to originator A, then sold to securitization sponsor B, who transferred to depositor C who in turn is transferring the note to trustee D, a complete chain of indorsements could be: 1) an indorsement from A to B, followed by an indorsement by B in blank, or 2) an indorsement by A in blank. Either of those examples of indorsements, together with delivery of the note to D, would be sufficient to effect a negotiation and transfer to D, and therefore would be a "complete" or "unbroken" chain of indorsements as required by standard PSA language. Examples of an incomplete or broken chain would be as follows: 1) no indorsement by A, or 2) an indorsement by A to X, followed by an indorsement by B in blank. Importantly, for the purposes for which indorsement is required by the PSA (which are limited to evidencing the transfer and delivery of the mortgage loans to the trustee), an indorsement by A in blank <u>is no less sufficient or effective</u> than an indorsement from A to B, followed by an indorsement from B to C, followed by an indorsement from C to D. In other words, the typical PSA does not impose contractual requirements that exceed those contained in the UCC, which has been adopted by all fifty states and the District of Columbia, as it pertains to the transfer of an interest in a mortgage note.

Moreover, the intended meaning of the typical PSA requirement for indorsements is illustrated by the contemporaneous conduct of the parties to the transactions. Sellers into securitizations generally deliver physical mortgage notes with indorsements in formats (following the example above) such as 1) an indorsement from A to B, followed by an indorsement by B in blank, or 2) an indorsement by A in blank. It was not at all typical nor required to show an indorsement to or from the depositor (C in this example). Furthermore, independent, third-party trustees and custodians checking in mortgage notes believed that a note showing indorsements in these formats satisfied the requirement that there be a 'complete' or 'unbroken' chain of indorsements. This actual conduct demonstrates the intended meaning of the indorsement requirements.

Mr. Levitin argues that the intended meaning of the typical PSA requirement for indorsements is that the requirement for a 'complete' or 'unbroken' chain means that every prior holder needs to have a separate indorsement to that holder. In other words that, following the above example, there must be an indorsement from A to B, followed by an indorsement from B to C, followed by an indorsement from C to D. Yet there is no persuasive basis for the proposition that the parties intended that the typical PSA provisions required this expanded chain of indorsements, nor is there any case law to support Mr. Levitin's view.

Mr. Levitin argues that as a result of his interpretation the indorsement requirements intended an expanded chain of indorsements, and the parties therefore intended to contract around the UCC and impose upon themselves indorsement requirements that are in excess of what is required to satisfy applicable UCC provisions. It is unclear and seemingly unreasonable to practicing industry lawyers why parties to a transaction would contract around the UCC by imposing significant additional indorsement requirements upon themselves, and then to have systematically failed to observe those expanded requirements. On the other hand, it is very reasonable to interpret the PSA language as not having been intended to require this expanded chain of indorsements above and beyond UCC requirements for indorsements, where the actual indorsement practice satisfied the UCC requirements.

Mr. Levitin offers the following argument to support the interpretation that an expanded chain of indorsements was intended to be required under PSA contractual provisions:

> "The reason for this additional requirement is to provide a clear evidentiary basis for all of the transfers in the chain of title in order to remove any doubts about the bankruptcy remoteness of the assets transferred to the trust. Absent a complete chain of indorsements, it could be argued that the trust assets were transferred directly from the originator to the trust, raising the concern that if the originator filed for bankruptcy, the trust assets could be pulled back into the originator's bankruptcy estate."[21]

However, this argument overlooks the fact that each separate step in the chain of transfers of ownership by each party from the originator to the trust is fully documented by a separate contract. In other words, there is a contract covering the sale from A to B, and another contract covering the sale from B to C, and the PSA itself documents the sale from C to D. There is no need for an expanded chain of indorsements to make the chain of transfers of ownership any more plain and evident than it already is. And there is no basis for the proposition that the parties thought that an expanded chain of indorsements to override the UCC was necessary or useful for this purpose.

B. Securitization Trusts Comply with New York Trust Law

Because the parties did not intend for the expanded chain of indorsements to be contractually required under the PSA, the further argument that the transfers to the trusts were void under New York trust law also fails.

[21] Testimony of Professor Adam J. Levitin, U.S. Senate Committee on Banking, Housing and Urban Affairs Hearing, November 16, 2010.
http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=df8cb685-c1bf-4eea-941d-cf9d5173873a

Professor Levitin cites New York E.P.T.L. Section 7.2-4 as authority for the concept that a transfer to a New York common law trust that is in contravention of the trust documents is void. However, that section actually refers to any "sale, conveyance or other act of the trustee *in contravention of the trust*" [emphasis added], not sales or conveyances *to the trust*. This section is intended to protect trust beneficiaries from unauthorized acts by the trustee. Cases interpreting this section relate to wrongful acts by trustees with respect to assets that have previously been transferred into the trust, such as acts that are illegal or which dissipate or impair assets of the trust. Moreover, this section contains an exception for any such acts that are authorized by any other provision of law. As we explained in the preceding section, the method used to convey the mortgage loans to the trustee is consistent with the UCC.

In his November 18 written testimony, it is stated that "transfers to New York common law trusts are governed by the common law of gifts." No authority is given for that statement, and we believe that this statement is not correct with respect to business or investment trusts, where transfers are made to the trust for consideration in commercial transactions, and not as gifts. The testimony then goes on to cite cases, which relate to the common law of gifts, for the proposition that assets must be transferred in a way "such that no one else could possibly claim ownership," and then reads the cases to impose on all transfers to New York common law trusts a requirement that "the mere recital of a transfer is insufficient to effectuate a transfer; there must be delivery in as perfect a manner as possible." The testimony goes on to argue that the contractual language in each PSA that transfers and conveys ownership of the mortgage loans to the trustee for the benefit of the investors is mere "recital" language that is ineffective in transfers to common law trusts, and further suggests that delivery of the note with an indorsement in blank is defective under this standard because it turns a note "into bearer paper to which others could easily lay claim."

The more recent of the cases cited in the testimony, Vincent v. Putnam, 248 N.Y. 76 (N.Y., 1928), involves a widow who received stocks and bonds by bequest from her husband, where the will provided that as to bequeathed remainder property that upon her death "shall remain at that time undisposed of", such property would pass to the husband's next of kin. The widow attempted to dispose of the stocks and bonds shortly before her own death by gift to one of her blood relatives. However, the only actions taken by the widow to effect the gift were to deliver the stock and bond certificates to her own attorney, with a verbal instruction to give them to her relative. This was not a transfer for consideration, and it was not a transfer to a common law trust. This case is about delivery of property to an agent of the donor, with an instruction to deliver the property to the intended donee, and the holding is that such delivery is not a completed gift. The "mere words" in this case, that were insufficient to effect a conveyance, were the verbal instruction to the widow's attorney to make the gift, which instruction could have been revoked at any time. We believe that the cases cited in the November 18 testimony do not support the proposition that transfers of property to a New York common law trust, for consideration in a commercial transaction, require a higher standard or more rigid set of transfer requirements than would apply in any transfer for value of such property in any other commercial transaction.

The notion that new legal decisions in all 50 states would be handed down with no legal precedence to nullify trillions of dollars of mortgage securitization transactions simply because the trusts acquired an interest in the pooled loans in accordance with applicable law but not in the manner that Mr. Levitin claims the trust documents require, appears on its face to be an unreasonable assertion. As noted above, we are confident that the standard processes of delivering loans into securitization trusts are proper as a matter of law and contract, and we are hard pressed to give any credence to an unsupported academic theory that the courts would thwart the intentions and expectations of the parties by voiding transfers of mortgage loans.

C. RMBS Trusts Effectively Achieve REMIC Status

A final issue that we would like to address in this section relates to Real Estate Mortgage Investment Conduits ("REMIC"), which is a tax election under federal income tax law frequently used for RMBS under which trusts backed by qualified mortgages can issue multiple classes of securities that are treated as debt, with the trust exempted from entity level taxation. One argument that has been advanced by a couple commentators is that if the mortgage loans were not validly transferred to the trust, any defect in the procedures used to make the transfer can now not be cured without violating regulations that prohibit transfers of qualified mortgages to a REMIC more than 90 days after it was created. We believe that this argument is without merit, because the argument that there were wholesale failures to properly convey ownership of mortgage loans to RMBS trusts are without merit as discussed above and in the ASF White Paper.

D. Mistakes Do Not Affect Validity of Transfer

The fact that the ASF White Paper finds that the standard industry practices are legally effective for participants in the secondary mortgage market to transfer mortgage loans does not mean that mistakes never happen. From time to time mistakes are certain to occur, particularly in a market where 55 million mortgages are transferred and/or serviced, and that is one reason why typical language in a PSA provides the opportunity to cure mistakes. It is important, however, to distinguish between document deficiencies that impair the validity of the transfer of mortgage loans, on the one hand, and the additional steps that may be necessary to enforce the loan documents against the borrowers, on the other hand. The three new concerns that we counter in this testimony call into question the validity of a mortgage loan transfer. We believe that these concerns are misplaced and that, in the ordinary course, document deficiencies on a one-off basis may delay foreclosure while the paperwork is corrected or completed but will not impair the initial transfer of the loan to the securitization trust.

In conclusion, the ASF greatly appreciates the invitation to appear before this Committee to share our views related to these current issues. I look forward to answering any questions the Committee may have.

Thank you.

ATTACHMENT A

ASF White Paper
Transfer and Assignment of Residential Mortgage Loans
in the Secondary Mortgage Market
November 16, 2010

Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market

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NOVEMBER 16, 2010

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American SECURITIZATION FORUM®

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Introduction

Recently, a few commentators have raised a number of legal theories questioning whether securitization trusts, either those created by private financial institutions or those created by government sponsored enterprises, such as Ginnie Mae, Fannie Mae or Freddie Mac, have valid legal title to the seven trillion dollars of mortgage notes in those trusts. In an effort to contribute thorough and well-researched legal analysis to the discussion of these theories, the American Securitization Forum ("ASF") issues the enclosed white paper entitled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market" (the "White Paper"). The White Paper provides a detailed overview of the legal principles and processes by which mortgage loans are typically held, assigned, transferred and enforced in the secondary mortgage market and in the creation of mortgage-backed securities ("MBS"). These principles and processes have centuries-old origins, and they have continued to be sound and validated since the advent of MBS over forty years ago.

While the real property laws of each of the 50 U.S. states and the District of Columbia affect the method of foreclosing on a mortgage loan in default, the legal principles and processes discussed in this White Paper result, if followed, in a valid and enforceable transfer of mortgage notes and the underlying mortgages in each of these jurisdictions. To be thorough, the White Paper undertakes a review of both common law and the Uniform Commercial Code (the "UCC") in each of the 50 U.S. states and the District of Columbia. One of the most critical principles is that when ownership of a mortgage note is transferred in accordance with common securitization processes, ownership of the mortgage is also automatically transferred pursuant to the common law rule that "the mortgage follows the note." The rule that "the mortgage follows the note" dates back centuries and has been codified in the UCC. In essence, this means that the assignment of a mortgage to a trustee does not need to be recorded in real property records in order for it to be a valid and binding transfer.

In summary, these traditional legal principles and processes are fully consistent with today's complex holding, assignment and transfer methods for mortgage loans and those methods are legally effective for participants in the secondary mortgage market to transfer mortgage loans. Thirteen major U.S. law firms noted in Exhibit A have reviewed the White Paper and believe that the Executive Summary contained therein represents a fair summary of the legal principles presented. ASF wishes to thank each of these firms and the dozens of preeminent MBS attorneys who have contributed to the development of this White Paper.

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum

Executive Summary

1. Basic Principles

The two core legal documents in most residential mortgage loan transactions are the promissory note and the mortgage or deed of trust that secures the borrower's payment of the promissory note. In a typical "private-label" mortgage loan securitization, each mortgage loan is sold to a trust through a series of steps. A mortgage note and a mortgage may be sold, assigned and transferred several times between the time the mortgage loan is originated and the time the mortgage loan ends up with the trust. The legal principles that govern the assignment and transfer of mortgage notes and related mortgages are determined, in significant part, by the Uniform Commercial Code ("UCC"), which has been adopted by all 50 states and the District of Columbia.[1]

The residential mortgage notes in common usage typically are negotiable instruments. As a general matter, under the UCC, a negotiable mortgage note can be transferred from the transferor to the transferee through the indorsement[2] of the mortgage note and the transfer of possession of the note to the transferee or a custodian on behalf of the transferee. An assignment of the related mortgage is also typically delivered to the transferee or its custodian, except in cases where the related mortgage identifies the Mortgage Electronic Registration System ("MERS") as the mortgagee. Such assignments generally are in recordable form, but unrecorded, and are executed by the transferor without identifying a specific transferee – a so-called assignment "in blank." Intervening assignments, in some cases, may be recorded in the local real estate records.

In some mortgage loan transactions, MERS becomes the mortgagee of record as the nominee of the loan originator and its assignees in the local land records where the mortgage is recorded, either when the mortgage is first recorded or as a result of the recording of an assignment of mortgage to MERS. This means that MERS is listed as the record title holder of the mortgage. MERS' name does not appear on the mortgage note, and the beneficial interest in the mortgage remains with the loan originator or its assignee. The documents pursuant to which MERS acts as nominee make clear that MERS is acting in such capacity for the benefit of the loan originator or its assignee. When a mortgage loan is originated with MERS as the nominal mortgagee (or is assigned to MERS post-origination), MERS tracks all future mortgage loan and mortgage loan servicing transfers and other assignments of the mortgage loan unless and until ownership or servicing is transferred (or the mortgage loan is otherwise assigned) to an entity that is not a MERS member. In this way, MERS serves as a central system to track changes in ownership and servicing of the mortgage loan. Fannie Mae, Freddie Mac and Ginnie Mae, among other governmental entities, permit mortgage loans that they purchase or securitize to be registered with MERS.

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[1] References to the UCC are to the Official Text of the Model UCC, as revised, issued by the National Conference of Commissioners on Uniform State Laws.

[2] Note that the UCC replaces the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this Executive Summary.

2. Transfer of Promissory Notes Secured by Mortgages

The law of negotiable instruments developed over the centuries as a way to encourage commerce and lending by making such instruments, including negotiable mortgage notes, as liquid and transferable as possible. The UCC, with state-specific variations, in significant part governs the assignment and transfer of mortgage notes. Article 3 of the UCC applies to the negotiation and transfer of a mortgage note that is a "negotiable instrument," as that term is defined in Article 3. In addition, Article 9 of the UCC applies to the sale of "promissory notes," a term that generally includes mortgage notes.

In addition, as a general matter, the securitization of a loan under a typical pooling and servicing agreement provides both for the negotiation of negotiable mortgage notes (by indorsement and transfer of possession to the securitization trustee or the custodian for the trustee) and for an outright sale and assignment of all of the mortgage notes and mortgages. Thus, whether the mortgage notes in a given securitization pool are deemed "negotiable" (as we believe most typically are) or "non-negotiable" will have little or no substantive effect under the UCC on the validity of the transfer of the notes. The typical securitization process effects valid transfers of the mortgage notes and related mortgages in accordance with the provisions of Articles 3 and 9 of the UCC.

Under the UCC, the transfer of a mortgage note that is a negotiable instrument is most commonly effected by (a) indorsing the note, which may be a blank indorsement that does not identify a person to whom the mortgage note is payable or a special indorsement that specifically identifies a person to whom the mortgage note is payable, and (b) delivering the note to the transferee (or an agent acting on behalf of the transferee). As residential mortgage notes in common usage typically are "negotiable instruments," this is the most common method to transfer the mortgage note. In addition, even without indorsement, the transfer can be effected by transferring possession under the UCC. Moreover, the sale of any mortgage note also effects the transfer of the mortgage under Article 9. Securitization agreements often provide both for (a) the indorsement and transfer of possession to the trustee or the custodian for the trustee, which would constitute a negotiation of the mortgage note under Article 3 of the UCC and (b) an outright sale and assignment of the mortgage note. Thus, regardless of whether the mortgage notes in a securitization trust are deemed "negotiable" or "non-negotiable," the securitization process generally includes a valid transfer of the mortgage notes to the trustee in accordance with the explicit requirements of the UCC.

In addition, Article 3 of the UCC permits a person without possession to enforce a negotiable mortgage note where the note has been lost, stolen, or destroyed. Courts have consistently affirmed the use of the salient provisions of the UCC to enforce lost, stolen or destroyed negotiable mortgage notes that are owned by a securitization trust when the trust or its agent has proved the terms of the mortgage notes and their right to enforce the mortgage notes.

3. Assignment and Transfer of Ownership of Mortgages

As stated above, when a mortgage loan is assigned and transferred as part of the securitization of the mortgage loan in the secondary market, both the mortgage note and the mortgage itself are typically sold, assigned, and physically transferred to the trustee that is acting on behalf of the MBS investors or a trustee-designated document custodian pursuant to a custody agreement. The assignment and transfer are usually documented in accordance with a pooling and servicing agreement.

When a mortgage note is transferred in accordance with common mortgage loan securitization processes, the mortgage is also automatically transferred to the mortgage note transferee pursuant to the general common law rule that "the mortgage follows the note." The rule that "the mortgage follows the note" has been codified in the UCC, but the rule's common law origins date back hundreds of years, long before the creation of the UCC. As stated in the official comments to UCC § 9-203(g), the section "codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9. All states follow this rule.[3]

In addition to the codification under UCC § 9-203(g), reported court cases in nearly every state and non-UCC statutory provisions in some states make clear that "the mortgage follows the note." Regarding the impact of these UCC provisions, one treatise states: "Article 9 makes it as plain as possible that the secured party need not record an assignment of mortgage, or anything else, in the real property records in order to perfect its rights in the mortgage." J. McDonnell and J. Smith, Secured Transactions Under the Uniform Commercial Code, § 16.09[3][b]. Indeed, courts in several states have affirmed and applied the "mortgage follows the note" rule in cases where the mortgage assignment was not recorded by the transferee and even when there was no actual separate written assignment of the mortgage.[4]

Common securitization practices are consistent with the general rule that "the mortgage follows the note": pursuant to the pooling and servicing agreement that governs an MBS, and the language of assignment typically contained in such an agreement, the mortgage note and the mortgage itself are sold, assigned, transferred and delivered to the trustee, and the transferor also typically delivers a written assignment of the mortgage that is in blank in recordable form. Courts have held that the language of sale and assignment contained in a pooling and servicing agreement, along with the corresponding transfer, sale, and delivery of the mortgage note and mortgage, are sufficient to transfer the mortgage to the transferee/trustee or its designee or nominee.

The creation of an interest in or lien on real property, including a mortgage, is governed by the non-UCC law of the state in which the property is located. Likewise, the enforceability of mortgages (including the right and method to foreclose) is subject to all of the conditions precedent and requirements that are set forth in the particular mortgage itself and in all applicable state and local laws. Those conditions precedent

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[3] However, in some states, such as Massachusetts and Minnesota, courts have held that the transfer of a mortgage note without an express transfer of the mortgage vests in the note holder only an equitable interest in the mortgage. This arrangement has been described as follows: the holder of the mortgage holds the legal title to the mortgage in constructive trust for the benefit of the mortgage note holder. In both states, however, case law suggests that foreclosure proceedings must be initiated by, or at least in the name of, the holder of the legal title in the mortgage.

[4] In most states, recording of an assignment of mortgage is generally not required to ensure the enforceability of the assignment of mortgage as between the assignor and assignee, and anyone with knowledge thereof. It is beyond the scope of this Executive Summary and the White Paper to discuss in detail the potential risks to the mortgage transferee of not recording a mortgage assignment. Those risks might include, among others, delaying the transferee's ability to foreclose on the mortgage, failing to receive notices that may go to the mortgagee of record, and otherwise leaving the assignee open to negligent or fraudulent actions or inactions by the mortgagee of record that could bind the mortgage transferee and impair the value or enforceability of the mortgage. Similarly, when an assignment of mortgage is not recorded, the assignor may be liable for certain obligations imposed upon a mortgagee of record, such as the obligation to provide a pay-off statement or mortgage release within a designated time period.

and procedural requirements vary from mortgage to mortgage and from state to state. Thus, ownership of a mortgage (i.e., without notice to the mortgagor or the public, without judicial proceedings (where required), without satisfaction of other conditions precedent or procedural requirements in the mortgage itself or in applicable state law), does not always give the holder of the mortgage the legal ability to foreclose on the mortgage. Though a discussion of the other necessary prerequisites to foreclosure is beyond the scope of this Executive Summary and the White Paper, the fact that other steps may need to be taken by the owner of a mortgage note, or the owner of a mortgage, is neither unique nor surprising in our legal and regulatory system and does not diminish an otherwise legally effective transfer of the mortgage note and mortgage.

The use of MERS as the nominee for the benefit of the trustee and other transferees in the mortgage loan securitization process has been a subject of litigation in recent years regarding a mortgage note holder's right to enforce a mortgage loan registered in MERS. Some cases address the authority or ability of MERS or transferees of MERS to foreclose on a mortgage for which MERS is or was the mortgagee of record. As a general matter, the assignment and transfer of a mortgage to MERS as nominee of and for the benefit of the beneficial owner of the mortgage does not adversely impact the right to foreclose on the mortgage. Decisions in many jurisdictions support this conclusion.

There are several minority decisions that, in some form, have taken issue with MERS. But none of these decisions, to our knowledge, has invalidated a mortgage for which MERS is the nominee, and none of these decisions has challenged MERS' ability to act as a central system to track changes in the ownership and servicing of mortgage loans.

Finally, it is important to recognize that the UCC does not displace traditional rules of agency law. Under general agency law, an agent has authority to act on behalf of its principal where the principal "manifests assent" to the agent "that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Accordingly, the UCC does not prevent MERS or others, including loan servicers, from acting as the agent for the note holder in connection with transfers of ownership in mortgage notes and mortgages. In short, principles of agency law provide MERS and loan servicers another legal basis for their respective roles in the transfer of mortgage notes and mortgages.

4. Conclusion

In summary, the longstanding and consistently applied rule in the United States is that, when a mortgage note is transferred, "the mortgage follows the note." When a mortgage note is transferred and delivered to a transferee in connection with the securitization of the mortgage loan pursuant to an MBS pooling and servicing agreement or similar agreement, the mortgage automatically follows and is transferred to the mortgage note transferee, notwithstanding that a third party, including an agent/nominee entity such as MERS, may remain as the mortgagee of record. Both common law and the UCC confirm and apply this rule, including in the context of mortgage loan securitizations.

Exhibit A

- Alston & Bird LLP
- Bingham McCutchen LLP
- Cadwalader, Wickersham & Taft LLP
- Dechert LLP
- Hunton & Williams LLP
- Katten Muchin Rosenman LLP
- K&L Gates LLP
- Lowenstein Sandler PC
- Mayer Brown LLP
- O'Melveny & Myers LLP
- Orrick, Herrington & Sutcliffe LLP
- Sidley Austin LLP
- SNR Denton US LLP

Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market

The beginnings of the now multi-trillion dollar secondary market for residential mortgage loans date back to the federal government's creation of Fannie Mae in 1938. Since then, the complexity of the secondary mortgage market has increased, especially as a result of the rapid growth and market acceptance of mortgage-backed securities ("MBS") that began in the 1980s. In contrast, the legal principles and processes by which mortgage-related promissory notes and security instruments (mortgages and deeds of trust) are assigned and transferred have centuries-old origins. Now, in the midst of the worst economic and housing crisis since the 1930s, some are questioning whether the traditional state law principles and processes of assignment and transfer can be fully reconciled with today's complex holding, assignment and transfer systems for mortgage-related promissory notes and security instruments, and what methods are legally effective for participants in the secondary mortgage market to establish, maintain and transfer mortgage notes and security instruments.

This paper provides an overview of the legal principles and processes by which promissory notes and related mortgage security instruments are typically held, assigned, transferred and enforced in the secondary mortgage market in connection with loan securitizations and the creation of MBS.[1]

1. Basic Principles

The two core legal documents in most residential mortgage loan transactions are the promissory note and the mortgage or deed of trust that secures the borrower's payment of the promissory note. The promissory note contains a promise by the borrower to pay the lender a stated amount of money at a specified interest rate (which can be fixed or variable) by a certain date. The typical mortgage or deed of trust contains a grant of a mortgage lien or other security interest in the borrower's real property to the lender or, in a deed of trust, to a trustee for the benefit of the lender, to secure the borrower's obligations under the promissory note.[2]

In a typical "private-label" mortgage loan securitization, each mortgage loan, which is evidenced by a mortgage note and secured by a mortgage, is sold, assigned and transferred to a trust through a series of steps:

- The loan originator or a subsequent purchaser sells, assigns and transfers the mortgage loans to a "sponsor," which is typically a financial services company or a mortgage loan conduit or aggregator.

- The sponsor sells, assigns and transfers the mortgage loans to a "depositor," which in turn sells, assigns and transfers the mortgage loans to the trustee, which will hold the mortgage loans in trust for the benefit of the certificateholders.

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[1] Issues related to a party's right to foreclose or to engage in foreclosure-related activities are generally outside the scope of this paper.

[2] For ease of reference, "mortgage" will be used throughout much of this paper to refer to both mortgages and deeds of trust, and "mortgage note" will be used to refer to a promissory note that is secured by a mortgage.

- The trustee issues the MBS pursuant to a pooling and servicing agreement or trust agreement entered into by the depositor, the trustee and a master servicer or servicers.

- The trustee administers the pool assets, typically relying on the loan servicer to perform most of the administrative functions regarding the pool of mortgage loans. In addition, a document custodian is often designated to conduct a review of the mortgage loan documents pursuant to the requirements of the pooling and servicing agreement and to hold the mortgage loan documents for the loans included in the trust pool.

- In general, the loan documents are assigned and transferred from the depositor to the trustee through the indorsement of the mortgage note and the transfer of possession of the mortgage note to the trustee or a custodian on behalf of the trustee. An assignment of the related mortgage is also typically delivered to the transferee or its custodian, except in cases where the related mortgage identifies Mortgage Electronic Registration Systems ("MERS") as the mortgagee. Such assignments generally are in recordable form, but unrecorded, and are executed by the transferor without identifying a specific transferee – a so called assignment in blank.

- In some mortgage loan transactions, MERS becomes the mortgagee of record as the nominee of the loan originator and its assignee in the local land records where the mortgage is recorded, either when the mortgage is first recorded or as a result of the recording of an assignment of mortgage to MERS. This means that MERS is listed as the record title holder of the mortgage. MERS' name does not appear on the mortgage note, and the beneficial interest in the mortgage remains with the loan originator or its assignee. The documents pursuant to which MERS acts as nominee make clear that MERS is acting in such capacity for the benefit of the loan originator or its assignee. When a mortgage loan is originated with MERS as the nominal mortgagee (or is assigned to MERS post-origination), MERS tracks all future mortgage loan and loan servicing transfers and other assignments of the mortgage loan unless and until ownership or servicing is transferred (or the loan is otherwise assigned) to an entity that is not a MERS member. In this way, MERS serves as a central system to track changes in ownership and servicing of the loan. Fannie Mae, Freddie Mac and Ginnie Mae, among other governmental entities, permit loans that they purchase or securitize to be registered with MERS.

As part of the loan securitization process detailed above, a mortgage note and a mortgage may be sold, assigned and transferred several times from one entity to another. The legal principles that govern the assignment and transfer of mortgage notes and mortgages are generally determined by state law. See, e.g., In re Cook, 457 F.3d 561, 566 (6th Cir. 2006) (state law governed whether transferee had superior interest in promissory note secured by mortgage). As such, these principles can vary depending upon the state in which the assignor of the mortgage notes, the underlying property, or the relevant mortgage-related documents are located. The assignment and transfer of a mortgage note, on the one hand, and of a mortgage, on the other hand, are addressed separately below.

2. Transfer of Promissory Notes Secured by Mortgages

The residential mortgage notes in common use in the secondary mortgage market typically are negotiable instruments. The law of negotiable instruments developed over the centuries as a way to encourage commerce and lending by making such instruments, including negotiable mortgage notes, as liquid and transferable as possible. See, e.g., Overton v. Tyler, 3 Pa. 346, 347 (1846) ("[A] negotiable bill or note is a courier without luggage"); 2 Frederick M. Hart & William F. Willier, Negotiable Instruments Under the Uniform Commercial Code § 1.01 ("Negotiable instruments play such an important role in the modern commercial world that it is difficult to realize that the struggle for their existence could be as long and complex as it has been, yet the evolution of the concept took centuries."). Similarly, the standardization of the forms of mortgage notes and mortgages over the past thirty years or more has contributed to the liquidity and transferability of mortgage notes and the underlying mortgages. See Peter M. Carrozzo, Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution, 39 Real Prop. Prob. & Tr. J. 765, 799-800 (2004-2005) ("standardization of mortgage documents created marketable commodities. Once mechanisms were in place for the secondary market to operate, events rapidly moved toward the ultimate goal: the creation of a security which has as its base land [and] yet which will be as freely transferable as stocks and bonds" (internal quotation omitted)).

The Uniform Commercial Code ("UCC"), which, with state-specific variations, has been adopted as law by all 50 states and the District of Columbia, governs, in significant part, the transfer of mortgage notes.[3] Article 3 applies to the negotiation and transfer of a mortgage note that is a "negotiable instrument," as that term is defined in Article 3. See UCC §§ 3-102, 3-201, 3-203 and 3-204; see, e.g., Swindler v. Swindler, 355 S.C. 245, 250 (S.C. Ct. App. 2003) (Article 3 governs negotiable mortgage note). In addition, Article 9 applies to the sale of "promissory notes," a term that generally includes all mortgage notes (both negotiable and non-negotiable). See UCC §§ 1-201(b)(35) and 9-109(a)(3).[4]

The residential mortgage notes in common use today are typically negotiable instruments for UCC purposes. In addition, as a general matter, the securitization of a loan under a typical pooling and servicing agreement provides both for the negotiation of negotiable mortgage notes (by indorsement[5] and transfer of possession to the securitization trustee or the custodian for the trustee) and for an outright sale and assignment of all of the mortgage notes and related mortgages. Thus, whether the mortgage notes in a given securitization

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[3] References to the UCC are to the Official Text of the Model UCC, as revised, issued by the National Conference of Commissioners on Uniform State Laws.

[4] While Article 9 does not directly govern a mortgage on real property, the fact that a mortgage note is itself secured by a mortgage on real property does not render Article 9 inapplicable to transfers of the mortgage note. See UCC § 9-109(b) ("The application of this article [9] to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.").

[5] Note that the UCC eschews the more common U.S. spelling of "endorsement" for the less common "indorsement." The UCC spelling is used throughout this paper.

pool are deemed “negotiable” (as we believe most typically are) or “non-negotiable” will have little or no substantive effect under the UCC on the validity of the transfer of the mortgage notes. The typical securitization process effects valid transfers of the mortgage notes and related mortgages in accordance with the provisions of Articles 3 and 9 of the UCC.[6]

What Constitutes a “Negotiable Instrument?”

A “negotiable instrument” is defined as:

> an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
>
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

UCC § 3-104(a).

Reference in a mortgage note to a mortgage does not affect the mortgage note’s status as a negotiable instrument. <u>See</u> UCC § 3-106(b) (“A promise or order is not made conditional [] by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration….”); <u>see</u> <u>also</u> <u>Int’l Minerals & Chem. Corp. v. Matthews</u>, 321 S.E.2d 545, 547 (N.C. Ct. App. 1984) (“referring to a mortgage or other collateral [in a mortgage note] does not impair negotiability” of the note); <u>In re AppOnline.com</u>, 285 B.R. 805, 815-16 (Bankr. E.D.N.Y. 2002) (reference in mortgage notes to underlying mortgages does not affect the negotiability of the notes).

The fact that a mortgage note contains a variable or adjustable interest rate also does not affect the mortgage note’s status as a negotiable instrument. That is because UCC § 3-112(b) provides that “[i]nterest may be stated in an instrument[[7]] as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument.” UCC § 3-112(b).

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[6] Article 3 and Article 9 are not mutually exclusive. Article 9 applies to the transfer of all “promissory notes,” which includes negotiable and non-negotiable instruments. Both Article 3 and Article 9 apply to “negotiable instruments.” With respect to non-negotiable instruments, only Article 9 applies to the transfer.

[7] UCC § 3-104(b) defines “instrument” simply as a “negotiable instrument” for purposes of Article 3. As discussed in more detail below, the definition of “instrument” in Article 9 (governing secured transactions) is somewhat more expansive.

How is a Negotiable Mortgage Note Transferred?[8]

A negotiable mortgage note is transferred when it is "delivered" by a person other than the mortgagor for the purpose of giving the transferee the right to enforce the note. See UCC § 3-203(a). "Delivery" of a mortgage note occurs when there has been a voluntary transfer of possession of the mortgage note. See UCC § 1-201(b)(15). As a general matter, the "[t]ransfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument . . . ." UCC § 3-203(b). Accordingly, a person in possession of the note becomes a "person entitled to enforce" if it can prove that it is the transferee.[9] See UCC § 3-301.

The easiest and most common way to transfer a negotiable mortgage note is through "negotiation." Article 3 defines "negotiation" as "a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder." UCC § 3-201(a). The "negotiation" of a negotiable mortgage note that is payable to an identified person or entity (such as the entity that originated a mortgage loan and whose name appears as the payee in the mortgage note) – "requires **transfer** of **possession** of the instrument and its **indorsement** by the **holder**." UCC § 3-201(b) (emphasis added). As explained below, "indorsement" and "holder" are both defined terms in the UCC.

The "holder" of a negotiable mortgage note is "the person in possession of [the mortgage note] that is payable either to bearer or to an identified person that is the person in possession." UCC § 1-201(b)(21)(A). In other words, upon the closing of a mortgage loan, the "holder" of the mortgage note is the entity that is the payee on the mortgage note and that possesses the note (either actually or constructively). After a negotiable mortgage note has been negotiated, such as in connection with a loan securitization, the "holder" of the mortgage note is the entity that possesses the mortgage note if the mortgage note was indorsed to that entity or if the mortgage note was indorsed in blank or to bearer.

The term "indorsement" is defined to include "a signature . . . that alone or accompanied by other words is made on an instrument [in our case, a negotiable mortgage note] for the purpose of . . . negotiating the instrument." UCC § 3-204(a). Such an indorsement may be either a "special indorsement" or a "blank indorsement." See UCC § 3-205. A "special indorsement" is a written indorsement that specifically "identifies a person to whom it makes the instrument payable." UCC § 3-205(a). A "blank indorsement" is an indorsement that does not identify a person to whom the instrument is payable. See UCC § 3-205(b). Mortgage notes that are transferred in connection with loan securitizations are typically indorsed in blank with language such as "Pay to the order of ____________," where no name is filled in the blank. The effect of an indorsement in

[8] It is important to note that Article 3 does not concern "ownership" of a mortgage note, but instead provides for the transfer of a mortgage note and the right to enforce such notes. See UCC § 3-301; UCC § 3-203 cmt. 1. A party need not be the "owner" of the mortgage note to enforce it. See UCC § 3-301 ("A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."). Thus, a party may have the right to enforce the instrument, but not have "ownership" of that instrument. UCC § 3-203 cmt 1. For an example of situations where a party with the right to enforce an instrument is not also the "owner" of the instrument, see UCC 3-203 cmt. 1 and Note 12 infra.

[9] Note also that UCC § 3-203(c) provides for the scenario in which an instrument is transferred for value without the indorsement that, as described in the text below, would be needed for the mortgage note to have been "negotiated." Under that section, if a negotiable mortgage note is transferred for value as part of a loan securitization, but the transferor fails to indorse the note, the transferee of the note has the "specifically enforceable right to the unqualified indorsement of the transferor." UCC § 3-203(c); see Note 12, infra (discussing distinction between the right to enforce a mortgage note and ownership of the mortgage note).

blank is significant: "When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of *possession* alone until specially indorsed." UCC § 3-205(b) (emphasis added).[10] See also UCC § 3-201(b) (The negotiation of a negotiable mortgage note that is payable to bearer (such as a negotiable mortgage note that has been indorsed in blank) is effected by "transfer of possession alone.").

The term "possession" is not defined in the UCC. Thus, courts rely on common law definitions of possession to interpret that concept in the context of the negotiation of an instrument such as a mortgage note. See, e.g., In re Kelton Motors, Inc., 97 F.3d 22, 26 (2d Cir. 1996) (because Article 3 does not define "possession," a court must look to the general law of the jurisdiction in determining whether a party is in possession of a negotiable instrument). Possession can be, and very often is, effected by an agent, nominee or designee, such as the designated custodian for the securitization trust. See, e.g., Midfirst Bank, SB v. C.W. Haynes and Co., Inc., 893 F. Supp. 1304, 1314-15 (D.S.C. 1994) (constructive possession exists when an authorized agent of the owner holds the note on behalf of the owner); Jenkins v. Evans, 31 A.D.2d 597, 598 (N.Y. App. Div. 3d Dept. 1968) (agent had authority to possess instruments for principal). In such cases, while the designated custodian has "physical" possession of the mortgage note, the trustee for which the custodian holds the mortgage note has "constructive" or "legal" possession. See Midfirst Bank, 893 F. Supp. at 1314-15; see also UCC § 9-313 cmt. 3 ("if the collateral is in [the] possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession" (emphasis added)).

Who May Enforce A Negotiable Mortgage Note?

The maker of a mortgage note is obligated to pay the note to the "person entitled to enforce the instrument." UCC § 3-412. The "person entitled to enforce" a negotiable mortgage note includes "(i) the holder of the instrument, [and] (ii) a nonholder in possession of the instrument who has the rights of a holder." UCC § 3-301. Accordingly, to enforce a mortgage note against the borrower, a person must generally prove either that it is a "holder" or that it is a transferee with the rights of a holder. See UCC § 3-301.

The first category of persons that may enforce a mortgage note is a "holder." A "holder" of a negotiable mortgage note is "the person in possession of [the mortgage note] that is payable either to bearer or to an identified person that is the person in possession." UCC § 1-201(b)(21)(A). The manner in which one becomes a "holder" is described in the section above.

The second category contemplated by UCC § 3-301– a "nonholder in possession who has the rights of a holder" – is more difficult to define. Under this clause, a person would qualify as a "nonholder in possession" if possession of the mortgage note was transferred to him from the transferor, but the transferor did not indorse the mortgage note. See UCC § 3-203 cmt. 2. In this circumstance, the transferee is entitled to enforce the instrument, but to do so, the transferee must first prove both possession of the unindorsed mortgage note and prove the transfer of the mortgage note by the holder to the transferee. See id.[11] Under both clauses, the person

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[10] An indorsement is considered to be made "on an instrument" for purposes of negotiation when it is made either on the mortgage note itself or on a separate paper, often referred to as an "allonge," that is affixed to the note. See UCC § 3-204(a). Once affixed, the allonge becomes "part of the instrument." Id.

[11] As noted above, the right to enforce an instrument and the ownership of that instrument are not necessarily the same. See UCC § 3-203 cmt. 1. Thus, a party may have the right to enforce the instrument, but not have "ownership" of that instrument. Id. A party

seeking to enforce the mortgage note must have possession of the note.

UCC § 3-301 also permits a person without possession to enforce a mortgage note where the mortgage note has been lost, stolen, or destroyed within the meaning of UCC § 3-309. See UCC § 3-301.[12] Courts have consistently affirmed the use of UCC § 3-309 to enforce lost, stolen or destroyed negotiable mortgage notes that a party, such as a securitization trustee, seeks to enforce when the party has proven the terms of the mortgage notes and its right to enforce the mortgage notes (i.e., it has proven the transfer of the mortgage note from the transferee). See, e.g., In re Montagne, 421 B.R. 65, 79 (D. Vt. 2009) (finding that plaintiff who satisfied requirements of UCC § 3-309 could enforce lost mortgage note); Waggoner v. Mortgage Elect. Registration Sys., Inc., No. 2003-CA-002666-MR, 2005 WL 2175439, at *1 n.1 (Ky. App. Ct. Sept. 9, 2005) ("The promissory note was proven … by an affidavit concerning a lost or destroyed promissory note.").

What Rights Against Borrower Defenses are Available to the Holder of a Negotiable Mortgage Note?

A key concept relating to the negotiation of negotiable mortgage notes is the "holder in due course" doctrine. That is because where the "holder" of a negotiable mortgage note is deemed a "holder in due course," the holder takes the mortgage note subject only to specific limited defenses of the borrower. The following is a brief summary of an expansive area of law. Under UCC § 3-302(a):

> [A] "holder in due course" means the holder of an instrument if:
>
> (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and
>
> (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306 [regarding claims of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds], and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).

UCC § 3-302(a).

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need not be the "owner" of the note to enforce it. See UCC § 3-301 ("A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."). For example, if X (holder of an instrument payable to X) sells the instrument to Y pursuant to a document conveying all of X's right, title and interest in the instrument to Y, but does not deliver immediate possession to Y, Y would have ownership of the instrument under the agreement, but Y generally would not be entitled to enforce the instrument until it obtained possession of the instrument. Id.

[12] UCC § 3-301 also permits a person without possession to enforce a mortgage note where, in certain circumstances, there has been mistaken payment as defined in UCC § 3-418(d).

Under Article 3, a holder in due course of a negotiable mortgage note takes the mortgage note free of (a) all prior claims to or regarding the mortgage note by any person and (b) most defenses to enforceability of the mortgage note that may be raised by parties with whom the holder in due course has not dealt. See UCC §§ 3-305 and 3-306; see also Provident Bank v. Community Home Mortgage Corp., 498 F. Supp. 2d 558, 565 (E.D.N.Y. 2007). The defenses to which a holder in due course may be subject are found in UCC § 3-305, and include:

> a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings.

UCC § 3-305(a)(1).

How Is a Mortgage Note Transferred Under Article 9 of the UCC?

The sale of mortgage notes is also governed, in significant part, by Article 9. Article 9 establishes (1) whether the interests of a transferee of a mortgage note have both "attached" and become "perfected" so that those interests will prevail over conflicting claims of third parties and (2) the rights of the transferee in and to the underlying mortgage that secures the mortgage note.

Article 9 addresses the sale of mortgage notes, regardless of whether they are negotiable or non-negotiable.[13] More specifically, Article 9 applies to "a sale of . . . promissory notes." UCC § 9-109(a)(3). A "promissory note" is defined as "an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds." UCC § 9-102(a)(65).[14] Given this broad definition, residential mortgage notes in common use today are typically "promissory notes" for purposes of Article 9.

Under Article 9, the sale of a mortgage note (whether or not the mortgage note is negotiable) is deemed a secured transaction and the transferee's "security interest" is automatically perfected when it attaches (more on "attachment" and "perfection" below). See UCC § 9-309(4). While security interests are most commonly thought of as the liens obtained by lenders, the UCC defines the term "security interest" to also include "any interest of a . . . buyer of . . . a promissory note in a transaction that is subject to Article 9." UCC § 1-201(b)(35) (emphasis

[13] Article 9 also applies to the creation of a lien on, or a "less-than-ownership security interest" in, a mortgage note. Because most assignments and transfers of mortgage notes in loan securitizations are of the ownership of the mortgage notes, not a mere lien on or security interest in the notes, this paper addresses only outright sales of mortgage notes under Article 9. The principles discussed below regarding attachment of a buyer's interest in a sale of mortgage notes are identical to those that apply in the context of the creation of a lien on mortgage notes, and the principles regarding perfection of the interest in the mortgage notes are likewise very similar. "Although . . . Article [9] occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither . . . Article [9] nor the definition of "security interest" (Section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts." UCC § 9-109 cmt 4.

[14] Under Article 9, the term "instrument" is defined broadly as "a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment." UCC § 9-102(a)(47).

added). In addition, the definition of "secured party" includes "a person to which . . . promissory notes have been sold." UCC § 9-102(a)(72)(D).

Before a buyer's "security interest" in a mortgage note can be perfected under Article 9, the security interest must "attach." A security interest attaches when (1) value has been given for the sale, (2) the seller has rights in the mortgage note or the power to transfer rights in the mortgage note to the buyer and (3) either (a) the mortgage note is in the possession of the buyer pursuant to a security agreement of the seller or (b) the seller has signed a written or electronic security agreement that describes the mortgage note. See UCC § 9-203(b). Article 9 defines "security agreement" as "an agreement that creates or provides for a security interest," UCC § 9-102(a)(73), which, in the context of a mortgage loan securitization, would include an agreement pursuant to which mortgages and mortgage notes are sold and transferred from one entity to another. Such an agreement, normally a pooling and servicing agreement or trust agreement, typically will provide that the transfer of the mortgage note pursuant thereto effects a sale of the mortgage note, which would thus, under Article 9, constitute a "security agreement."

Significantly, the attachment of a security interest in a mortgage note that is itself "secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage or other lien." UCC § 9-203(g) (emphasis added).[15] Similarly, under UCC § 9-308(e), perfection of a security interest in a promissory note "also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right." UCC § 9-308(e) (emphasis added). In other words, perfection of a security interest (which includes a sale to a buyer) in a mortgage note pursuant to Article 9 also perfects a security interest in the mortgage that secures the note.

Perfection of the interest in the mortgage note is important because it provides the transferee of the mortgage note with a right in the mortgage note and mortgage superior to that of a subsequent lien creditor of the seller. And, perfection provides the transferee of the mortgage note with a right in the mortgage superior to that of a subsequent lien creditor of the mortgagee, which includes a bankruptcy trustee (see UCC § 9-102(a)(52)). See UCC § 9-308 cmt. 6.

Transfer of Mortgage Notes: Conclusion

In summary, under the UCC, the transfer of a mortgage note that is a negotiable instrument is most commonly effected by indorsing the note, which may be a blank or special indorsement, and delivering the mortgage note to the transferee (or the agent acting on behalf of the transferee). As the residential mortgage notes in common usage typically are "negotiable instruments," this is the most common method of transfer. In addition, even without indorsement, the assignment can be effected by transferring possession under UCC § 3-203(a). Moreover, the sale of any mortgage note also effects the assignment and transfer of the mortgage under Article 9. The attachment and perfection of the buyer's interest in the mortgage note attaches and perfects

[15] The comments to UCC § 9-203 expressly provide that "Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9; see also Restatement (Third) of Property (Mortgages) § 5.4(a) (1997). The same holds true for UCC § 9-308(e), under which perfection of a security interest in a mortgage note also accomplishes perfection of a security interest in the mortgage. See UCC § 9-308 cmt. 6.

the buyer's interest in the underlying mortgage that secures the mortgage note. Securitization agreements often provide both for (a) the indorsement and transfer of possession to the trustee or the custodian for the trustee, which would constitute a negotiation of the mortgage note under Article 3 of the UCC and (b) an outright sale and assignment of the mortgage note. Thus, regardless of whether the mortgage notes in a securitization trust are deemed "negotiable" or "non-negotiable," the securitization process generally includes a valid transfer of the mortgage notes to the trustee in accordance with the explicit requirements of the UCC.

3. Assignment and Transfer of Ownership of Mortgages

As described above, when a mortgage loan is assigned and transferred as part of the securitization of the loan in the secondary market, both the mortgage note and the mortgage itself are typically sold, assigned, and physically transferred to the trustee that is acting on behalf of the MBS investors or to a trustee-designated document custodian pursuant to a custody agreement. The assignment and transfer are usually documented and performed in accordance with a pooling and servicing agreement.

What is the Relationship Between the Transfer of a Mortgage Note and the Transfer of Ownership of the Mortgage?

When a mortgage note is transferred in accordance with common mortgage loan securitization processes, the mortgage is also automatically transferred to the mortgage note transferee under the UCC and the general common law rule that "the mortgage follows the note." See, e.g., Carpenter v. Longan, 83 U.S. 271, 275 (1873) ("The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter."); Mortgage Elect. Registration Sys., Inc. v. Coakley, 41 A.D.3d 674, 674 (N.Y. App. Div. 2d Dept. 2007) ("the mortgage . . . passed as an incident to the promissory note"); Restatement (Third) of Property, Mortgages § 5.4(a) (1997) ("A transfer of an obligation secured by a mortgage also transfers the mortgage . . . . ").

The rule that "the mortgage follows the note" has been codified in the UCC, but the rule's common law origins date back hundreds of years, long before the creation of the UCC. As stated in the official comments to UCC § 9-203(g), that section "codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien." UCC § 9-203 cmt. 9.

All states follow this rule.[16] In addition to the codification of the rule under UCC § 9-203(g), reported

[16] However, in some states, such as Massachusetts and Minnesota, courts have held that the transfer of a mortgage note without an express transfer of the mortgage vests in the note holder only an equitable interest in the mortgage. See, e.g., First Nat'l Bank of Cape Cod v. North Adams Hoosac Savs. Bank, 7 Mass. App. Ct. 790, 796 (1979); Jackson v. Mortgage Elect. Registration Sys., Inc., 770 N.W.2d 487, 497, 500-01 (Minn. 2009). This arrangement has been described as follows: the holder of the mortgage holds the legal title to the mortgage in constructive trust for the benefit of the mortgage note holder. See First Nat'l Bank of Cape Cod, 7 Mass. App. Ct. at 796. In both states, however, case law suggests that foreclosure proceedings must be initiated by, or at least in the name of, the holder of the legal title in the mortgage. See Jackson, 770 N.W.2d at 500; U.S. Bank Nat'l Ass'n v. Ibanez, Nos. 08 MISC 384283 (KCL), 08 MISC 386755 (KCL), 2009 WL 3297551, at *11 (Mass. Land Ct. Oct. 14, 2009) (rejecting argument that note holders had authority to foreclose on mortgages for which their status as full mortgagees was in dispute) (currently on appeal to the Massachusetts Supreme Judicial Court).

court cases in nearly every state and non-UCC statutory provisions in some states make clear that "the mortgage follows the note":

Alabama: Armour Fertilizer Works v. Zills, 177 So. 136, 138 (Ala. 1937) ("when the note is secured by a mortgage, such mortgage follows the note").

Arizona: Ariz. Rev. Stat § 33-817 ("The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts.").

Arkansas: Leach v. First Cmty. Bank, No. CA 07-05, 2007 WL 2852599, at *1 (Ark. App. Ct. Oct. 3, 2007) ("Arkansas has long followed the rule that, in the absence of an agreement or a plain manifestation of a contrary intention, the security of the original mortgage follows the note or renewal thereof.").

California: Cal. Civ. Code § 2936 ("The assignment of a debt secured by mortgage carries with it the security"); In re Staff Mortgage & Invest. Corp., 625 F.2d 281, 284 (9th Cir. 1980) (in California, "[A] deed of trust is a mere incident of the debt it secures and . . . an assignment of the debt 'carries with it the security." (internal quotation omitted)).

Colorado: Carpenter v. Longan, 83 U.S. 271, 275 (1873) (in an appeal from the Supreme Court of Colorado Territory, the United States Supreme Court stated: "The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter.").

Connecticut: Conn. Gen. Stat. § 49-17 ("When any mortgage is foreclosed by the person entitled to receive the money secured thereby but to whom the legal title to the mortgaged premises has never been conveyed, the title to such premises shall, upon the expiration of the time limited for redemption and on failure of redemption, vest in him in the same manner and to the same extent as such title would have vested in the mortgagee if he had foreclosed, provided the person so foreclosing shall forthwith cause the decree of foreclosure to be recorded in the land records in the town in which the land lies."); In re AMSCO, Inc., 26 B.R. 358, 361 (Bankr. D. Conn. 1982) ("An assignment of the note carries the mortgage with it . . . .").

District of Columbia: Hill v. Hawes, 144 F.2d 511, 513 (D.C. Cir. 1944) (after mortgage note has been cancelled, cancellation of "any mortgage follows as a matter of course and does not require a separate action").

Florida: Capital Investors Co. v. Ex'rs of Estate of Morrison, 484 F.2d 1157, 1163 n.12 (4th Cir. 1973) ("That the mortgage follows the note it secures and derives negotiability, if any, from the note is the rule in Florida where the land under mortgage in this case was located." (citing Daniels v. Katz, 237 So.2d 58, 60 (Fla. App. 1970); Meyerson v. Boyce, 97 So.2d 488, 489 (Fla. App. 1957))); Margiewicz v. Terco Properties, 441 So.2d 1124, 1125 (Fla. Dist. Ct. App. 1983) (when a note secured by a mortgage is assigned, the mortgage follows the note into the hands of the mortgagee).

Illinois: Federal Nat'l Mort. Ass'n v. Kuipers, 314 Ill. App.3d 631, 635, 732 N.E.2d 723, 727 (Ill. Ct. App. 2000) ("The assignment of a mortgage note carries with it an equitable assignment of the mortgage by which it was secured. The assignee stands in the shoes of the assignor-mortgagee with regard to the rights and interests under the note and mortgage. . . . [I]n Illinois, the assignment of the mortgage note is sufficient to transfer the underlying mortgage.") (citations omitted).

Indiana: Lagow v. Badollet, 1 Blackf. 416, 1826 WL 1087, at *3 (Ind. 1826) ("a mortgage . . . follows the debt into whose hands soever it may pass").

Iowa: Bremer County Bank v. Eastman, 34 Iowa 392, 1872 WL 254, at *1 (Iowa 1872) ("The transfer of the note, secured by the mortgage, carried the mortgage with it as an incident to the debt, and the indorsee of the note could maintain an action in his own name, to foreclose the mortgage without any assignment thereon whatever.").

Kansas: Kan. Stat. Ann § 58-2323 ("The assignment of any mortgage as herein provided shall carry with it the debt thereby secured."); Bank Western v. Henderson, 255 Kan. 343, 354, 874 P.2d 632, 640 (1994) ("[T]he mortgage follows the note. A perfected claim to the note is equally perfected as to the mortgage.").

Maryland: In re Bird, No. 03-52010-JS, 2007 WL 2684265, at *2-4 (Bankr. D.Md. Sept. 7, 2007) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it . . . .").

Massachusetts: The transfer of a mortgage note, without the express transfer of the mortgage, vests in the note holder an equitable interest in the mortgage (an interest that can be enforced by the note holder) and the mortgage holder is deemed to hold the mortgage in constructive trust for the benefit of the note holder. See Weinberg v. Brother, 263 Mass. 61, 62 (1928); Barnes v. Boardman, 149 Mass. 106, 114 (1889); Morris v. Bacon, 123 Mass. 58, 59 (1877); First Nat'l Bank of Cape Cod v. North Adams Hoosac Savs. Bank, 7 Mass. App. Ct. 790, 796 (1979); see also In re Ivy Properties, Inc., 109 B.R. 10, 14 (Bankr. D. Mass. 1989) ("[U]nder Massachusetts common law the assignment of a debt carries with it the underlying mortgage, without necessity for the granting or recording of a separate mortgage assignment.").

Despite the above cited authorities, the Massachusetts Land Court in a recent opinion cast doubt on the "mortgage follows the note" rule:

> [E]ven a valid transfer of the note does not automatically transfer the mortgage. . . . The holder of the note may have an equitable right to obtain an assignment of the mortgage by filing an action in equity, but that is all it has. . . . The mortgage itself remains with the mortgagee (or, if properly assigned, its assignee) who is deemed to hold the legal title in trust for the purchaser of the debt until the formal assignment of the mortgage to the note holder or, absent such assignment, by order of the court in an action for conveyance of the mortgage. . . . But . . . the right to get something and actually having it are two different things.

U.S. Bank Nat'l Ass'n v. Ibanez, Nos. 08 MISC 384283 (KCL), 08 MISC 386755 (KCL), 2009 WL 3297551, at *11 (Mass. Land Ct. Oct. 14, 2009) (citations omitted).

> The Ibanez case appears to stand in stark contrast to the principles embodied in the UCC. The Ibanez case is currently pending on appeal before the Massachusetts Supreme Judicial Court, that state's highest court.

Michigan: Prime Fin. Serv. v. Vinton, 279 Mich. App. 245, 257, 761 N.W.2d 694, 704 (Mich. Ct. App. 2008) ("the transfer of a note necessarily includes a transfer of the mortgage with it") (citing Ginsberg v. Capitol City Wrecking Co., 300 Mich. 712, 717, 2 N.W.2d 892 (1942)); Jones v. Titus, 208 Mich. 392, 397, 175 N.W. 257, 259 (Mich. 1919) (when a note given with a mortgage was indorsed over to a third party it carried with it the equitable title to the mortgage).

Minnesota: Jackson v. Mortgage Elect. Registration Sys., Inc., 770 N.W.2d 487, 497 (Minn. 2009) ("Absent an agreement to the contrary, an assignment of the promissory note operates as an equitable assignment of the underlying security interest.") (emphasis in original).

Mississippi: Holmes v. McGinty, 44 Miss. 94, 1870 WL 4406, at *4 ("[T]he mortgage . . . follows the debt as an incident, and is a security for whomsoever may be the beneficial owner of it.").

Missouri: George v. Surkamp, 76 S.W.2d 368, 371 (Mo. 1934) (when the holder of the promissory note assigns or transfers the note, the deed of trust is also transferred).

Montana: First Nat'l Bank v. Vagg, 65 Mont. 34, 212 P. 509, 511 (Mont. 1922) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it, while the assignment of the latter alone is a nullity. The mortgage can have no separate existence.") (citations omitted).

Nebraska: In re Union Packing Co., 62 B.R. 96, 100 (Bankr. D. Neb. 1986) (with or without the assignment of the mortgage, the assignee of the promissory note has the right to enforce the mortgage securing the note).

New Hampshire: Southerin v. Mendum, 5 N.H. 420, 1831 WL 1104, at *7 (N.H. 1831) ("When a mortgagee transfers to another person , the debt which is secured by the mortgage, he ceases to have any control over the mortgage. . . . And we are of the opinion, that the interest of the mortgagee passes in all cases with the debt, and that it is not within the statute of frauds, because it is a mere incident to the debt, has no value independent of the debt, and cannot be separated from the debt.").

New Jersey: In re Kennedy Mort. Co., 17 B.R. 957, 966 (Bankr. D. N.J. 1982) ("Anyone interested in acquiring an interest in the mortgage would be obliged to obtain an interest in the debt.").

New York: Mortgage Elec. Registration Sys., Inc. v. Coakley, 41 A.D.3d 674, 838 N.Y.S.2d 622 (App. Div. 2007) ("at the time of the commencement of this action, MERS was the lawful holder of the promissory note (see UCC 3-204[1]; Franzese v. Fidelity N.Y. FSB, 214 A.D.2d 646, 625 N.Y.S.2d 275), and of the mortgage, which passed as an incident to the promissory note (see Payne v. Wilson, 74 N.Y. 348, 354-355; see also Weaver Hardware Co. v. Solomovitz, 235 N.Y. 321, 139 N.E. 353; Matter of Falls, 31 Misc. 658, 660, 66 N.Y.S. 47, aff'd. 66 A. D. 616, 73 N.Y.S. 1134") (emphasis added); Provident Bank v. Community Home Mortgage Corp., 498 F. Supp. 2d 558, 564-65 (E.D.N.Y. 2007) (applying principle that the mortgage follows the note).

North Carolina: Dixie Grocery Co. v. Hoyle, 204 N.C. 109, 167 S.E. 469 (1933) ("The mortgage follows the debt.").

Ohio: U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) ("[T]he negotiation of a note operates as an equitable assignment of the mortgage, even when the mortgage is not assigned or delivered. Kuck v. Sommers (1950), 100 N.E.2d 68, 75, 59 Ohio Abs. 400. Various sections of the Uniform Commercial Code, as adopted in Ohio, support the conclusion that the owner of a promissory note should be recognized as the owner of the related mortgage. . . . Thus, although the recorded assignment is not before us, there is sufficient evidence on the record to establish that appellee is the current owner of the note and mortgage at issue in this case, and, therefore, the real party in interest.") (citations to Ohio's versions of UCC §§ 9-109(a)(3), 9-102(a)(72)(D) and 9-203(g) omitted).

Oklahoma: Zorn v. Van Buskirk, 111 Okla. 211, 239 P. 151 (1925) ("the mortgage follows the note").

Pennsylvania: In re Miller, No. 99-25616JAD, 2007 WL 81052, at *6 & n.7 (Bankr. W.D. Pa. Jan. 9, 2007) (citing and quoting with approval Gray, Mortgages in Pennsylvania at § 1-3 (1985) ("the mortgage follows the note")).

South Carolina: MidFirst Bank, SSB v. C.W. Haynes & Co., Inc., 893 F. Supp. 1304, 1318 (D. S.C. 1994) ("South Carolina recognizes the 'familiar and uncontroverted proposition' that 'the assignment of a note secured by a mortgage carries with it an assignment of the mortgage.' Hahn v. Smith, 157 S.C. 157, 154 S.E. 112 (1930); Ballou v. Young, 42 S.C. 170, 20 S.E. 84 (1894).").

Texas: Kirby Lumber Corp. v. Williams, 230 F.2d 330, 333 (5th Cir. 1956) (applying Texas law) ("The rule is fully recognized . . . that a mortgage to secure a negotiable promissory note is merely an incident to the debt, and passes by assignment or transfer of the note.").

Utah: Smith v. Jarman, 211 P. 962, 966 (Utah 1922) ("The modern doctrine that the mortgage follows the note as an incident was thus long ago recognized by this court . . . .").

Virginia: Yerby v. Lynch, 3 Gratt. 460, 1847 WL 2384, at *8-10 (Va. 1847) ("the mortgage follows the debt").

Virgin Islands: UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) (citing and quoting with approval the "RESTATEMENT (THIRD) OF PROPERTY, MORTGAGES § 5.4(a) (1997). The comment to this section further explains that '[t]he principle of this subsection, that the mortgage follows the note, ... applies even if the transferee does not know that the obligation is secured by a mortgage.... Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it.' Id. § 5.4 cmt. b (1997). Accordingly, in the Virgin Islands, no separate document specifically assigning and transferring the mortgage which secures a note is required to accompany the assignment of the obligation, because the mortgage automatically follows the note.").

Washington: Nance v. Woods, 79 Wash. 188, 189, 140 P. 323, 323 (Wash. 1914) ("the mortgage follows the note").

As mentioned above, the general common law rule that "the mortgage follows the note" is codified in Article 9 of the UCC. Section 9-203(g) of the UCC states: "The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien."[17] UCC § 9-203(g) (emphasis added). The phrase "security interest" in this provision includes a buyer's ownership interest because UCC § 1-201(b)(35) defines "security interest" to include "any interest of a . . . buyer of . . . a promissory note in a transaction that is subject to Article 9." Thus, under Article 9, a sale of a mortgage note means that the buyer's rights attach not only to the mortgage note itself but also to the mortgage that secures the mortgage note. Moreover, under UCC § 9-308(e), those rights are perfected and can be enforced against third parties.[18] Regarding the impact of these UCC provisions, one treatise states: "Article 9 makes it as plain as possible that the secured party need not record an assignment of mortgage, or anything else, in the real property records in order to perfect its rights in the mortgage." J. McDonnell and J. Smith, Secured Transactions Under the Uniform Commercial Code, § 16.09[3][b].

Courts in several states have affirmed and applied the "mortgage follows the note" rule in cases where the mortgage assignment was not recorded by the transferee.[19] See, e.g., Nat'l Livestock Bank v. First Nat. Bank, 203 U.S. 296, 307-08 (1906) (citing with approval a decision of the Supreme Court of Kansas for the proposition that "where a mortgage upon real estate is given to secure payment of a negotiable note, and before its maturity the note and mortgage are transferred by indorsement of the note to a bona fide holder, the assignment, if there be a written one, need not be recorded"); Jackson v. Mortgage Elec. Registration Sys., Inc., 770 N.W.2d 487, 497-98, 500 (Minn. 2009) (applying the "mortgage follows the note" rule where there was no assignment of the mortgage); UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) ("Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it."); Federal Nat'l Mort. Ass'n v. Kuipers, 314 Ill. App. 3d 631, 635, 732 N.E.2d 723, 727 (Ill. Ct. App. 2000) ("Because the assignment of the debt, with nothing more, is sufficient to preserve the mortgage lien, it cannot follow that the lien is somehow extinguished for the failure to record the assignment. Therefore, we are persuaded that the

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[17] Courts have observed that UCC § 9-203(g) codifies the "mortgage follows the note" rule. See, e.g., U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) (quoting with approval Official Comment 9 to UCC § 9-203: "subsection (g) [of UCC § 9-203] codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien").

[18] As discussed above, UCC § 9-308(e) provides that "perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right." UCC § 9-308(e) (emphasis added).

[19] In most states, recording of an assignment of mortgage is generally not required to ensure the enforceability of the assignment of mortgage as between the assignor and assignee, and anyone with knowledge thereof. It is beyond the scope of this paper to discuss in detail the potential risks to the mortgage transferee of not recording a mortgage assignment. Those risks might include, among others, delaying the transferee's ability to foreclose on the mortgage, failing to receive notices that may go to the mortgagee of record, and otherwise leaving the assignee open to negligent or fraudulent actions or inactions by the mortgagee of record that could bind the mortgage transferee and impair the value or enforceability of the mortgage. Similarly, when an assignment of mortgage is not recorded, the assignor may be liable for certain obligations imposed upon a mortgagee of record, such as the obligation to provide a pay-off statement or mortgage release within a designated time period.

mortgage lien and priority position inure to the benefit of the assignee and that recording the assignment is unnecessary to preserve the security for the debt."); In re Kennedy Mortgage Co., 17 B.R. 957, 964 (Bankr. D.N.J. 1982) ("The fact that assignments of mortgages may be recorded does not affect the validity of an assignment of a mortgage which has not been recorded.").

Courts have also affirmed and applied the "mortgage follows the note" rule even when there was no actual separate written assignment of the mortgage. See, e.g., Carpenter v. Longan, 83 U.S. 271, 275 (1873) ("The transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter."); Chase Home Fin., LLC v. Fequiere, 119 Conn. App. 570, 989 A.2d 606, 610-11 (Conn. Ct. App. 2010) ("General Statutes § 49-17 [which codifies the "mortgage follows the note" rule] permits the holder of a negotiable instrument that is secured by a mortgage to foreclose on the mortgage even when the mortgage has not yet been assigned to him." (emphasis added)); U.S. Nat'l Bank Ass'n v. Marcino, 181 Ohio App.3d 328, 337 (2009) (holding that bank was the "current owner" of a mortgage note and the related mortgage despite the fact that "there is no evidence on the record that appellee is the current assignee of the note and mortgage," and finding that "the negotiation of a note operates as an equitable assignment of the mortgage, even when the mortgage is not assigned or delivered" (citing Kuck v. Sommers, 100 N.E.2d 68, 75, 59 Ohio Abs. 400 (1950)); UMLIC VP LLC v. Matthias, 234 F. Supp. 2d 520, 523 (D. V.I. 2002) (the principle "that the mortgage follows the note, . . . applies even if the transferee does not know that the obligation is secured by a mortgage"); In re Union Packing Co., 62 B.R. 96, 100 (Bankr. D. Neb. 1986) (with or without the assignment of the mortgage, the assignee of the promissory note has the right to enforce the mortgage securing the note); Morris v. Bacon, 123 Mass. 58, 59 (1877) (note holder that endorsed and delivered mortgage note to bank as security for a loan, but without an assignment of the mortgage, was required by the court to transfer the mortgage to the bank); Bremer County Bank v. Eastman, 34 Iowa 392, 1872 WL 254, at *1 (Iowa 1872) ("The transfer of the note, secured by the mortgage, carried the mortgage with it as an incident to the debt, and the indorsee of the note could maintain an action in his own name, to foreclose the mortgage without any assignment thereon whatever."); Southerin v. Mendum, 5 N.H. 420, 1831 WL 1104, at *8 (N.H. 1831) ("the right of the mortgagee before foreclosure is . . . assignable by a mere assignment of the debt, without deed or writing").

Common MBS practices, as described above, are consistent with the general rule that "the mortgage follows the note": pursuant to the pooling and servicing agreement that governs a mortgage-loan securitization, and the language of assignment typically contained in such an agreement, the mortgage note and the mortgage itself are sold, assigned, transferred and delivered to the trustee, and the transferor also typically delivers a written assignment of the mortgage that is in blank in recordable form. Courts have held that the language of assignment contained in a pooling and servicing agreement, along with the corresponding transfer, sale and delivery of the mortgage note and mortgage, are sufficient to transfer the mortgage to the transferee/trustee or its designee or nominee. See, e.g., Wells Fargo Bank, N.A. v. Konover, No. 3:05 CV 1924 (CFD), 2009 WL 2710229, at *3 (D. Conn. Aug. 21, 2009) (MBS pooling agreement vested authority in pool trustee to bring legal action in the event of default); U.S. Bank N.A. v. Cook, No. 07 C 1544, 2009 WL 35286, at *2-3 (N.D. Ill. Jan. 6, 2009) (MBS pooling trust agreement effected an assignment of the mortgage at issue to the pool trustee); In re Samuels, 415 B.R. 8, 18 (Bankr. D. Mass. 2009) ("The [Pooling and Servicing Agreement] itself [by which the MBS loan trust was created], in conjunction with the schedule of mortgages deposited through it into the pool trust, served as a written assignment of the designated mortgage loans, including the mortgages themselves."); EMC Mortgage Corp. v. Chaudhri FSB, 400 N.J. Super. 126, 141, 946 A.2d 578, 588 (N.J. Super. Ct. 2008) ("any [mortgage] assignment shall pass and convey the estate of the assignor in the mortgaged premises, and the assignee may sue thereon in his own name."' (citing New Jersey Stat. Ann. § 46:9-9 and Byram Holding Co. v. Bogren, 2 N.J. Super. 331, 336, 63 A.2d 822 (N.J. Ch. Div. 1949)); LaSalle Bank N.A. v. Lehman Bros. Holdings, Inc., 237 F. Supp. 2d 618, 632-33 (D. Md. 2002) (MBS pooling agreement granted trustee authority to bring suit on behalf of trust); LaSalle Bank N.A. v. Nomura Asset Capital Corp., 180 F. Supp. 2d 465, 470-71 (S.D.N.Y. 2001) (language in the pooling and servicing agreement for MBS trust effectually assigned mortgage to the pool trustee).[20]

What is the Relationship Between the UCC and State Real Property Laws?

Article 9 does not apply to "the creation or transfer of an interest in or lien on real property, . . . except to the extent that provision is made for . . . liens on real property in Sections 9-203 and 9-308." UCC § 9-109(d)(11) (emphasis added). As discussed above, UCC § 9-203(g) provides that, when a security interest in a mortgage note attaches, a security interest in the underlying mortgage also attaches, and UCC § 9-308(e) provides the same regarding the perfection of the security interest. See UCC § 9-203 cmt. 9 (the "mortgage follows the note" rule codified into UCC §§ 9-203(g) and 9-308(e)). In addition, UCC § 9-109(b) makes clear that Article 9 does apply to mortgage notes even though Article 9 does not govern the creation of the mortgage itself:

> The application of this article [9] to a security interest [remember that this term is defined to include any interest of a buyer of a promissory note in a transaction subject to Article 9] in a secured obligation [e.g., mortgage note] is not affected by the fact that the obligation [e.g., mortgage note] is itself secured by a transaction or interest [e.g., creation of the mortgage or deed of trust itself] to which this article does not apply.

UCC § 9-109(b).[21]

The creation of an interest in or lien on real property, including a mortgage, is governed by the non-UCC law of the state in which the property is located. See, e.g., Oregon v. Corvallis Sand and Gravel Co., 429 U.S. 363, 378-79 (1977). Likewise, the enforceability of mortgages (including the right and

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[20] Although the rule is "the mortgage follows the note" when a mortgage note is assigned, some case law indicates that the converse is not true and that the mortgage note does not necessarily follow the mortgage if there is an attempted assignment of the mortgage alone or separate from the mortgage note. See, e.g., Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623 (Mo. Ct. App. 2009) ("An assignment of the deed of trust separate from the note has no 'force.'"); Saxon Mort. Serv., Inc. v. Hillery, No. C-08-4357 EMC, 2008 WL 5170180, at *4-5 (N.D. Cal. Dec. 9, 2008) ("For there to be a valid assignment, there must be more than just assignment of the deed [of trust] alone; the note must also be assigned."); In re Wilhelm, 407 B.R. 392, 400-05 (Bankr. D. Idaho 2009); Kelley v. Upshaw, 39 Cal.2d 179, 192 (1952) ("In any event, Kelley's purported assignment of the mortgage without an assignment of the debt which is secured was a legal nullity."). This is consistent with the longstanding aspect of the "mortgage follows the note" rule that "the note and mortgage are inseparable; the former as essential, the latter as an incident." In re Bird, No. 03-52010-JS, 2007 WL 2684265, at *2-4 (Bankr. D.Md. Sept. 7, 2007).

[21] UCC Article 3, which applies to negotiable mortgage notes, does not apply to mortgages themselves because mortgages do not fit the definition of "negotiable instrument" in UCC § 3-104(a).

method to foreclose) is subject to all of the conditions precedent and requirements that are set forth in the particular mortgage itself and in all applicable state and local laws. Those conditions precedent and procedural requirements vary from mortgage to mortgage and from state to state. Thus, ownership of a mortgage (i.e., without notice to the mortgagor or the public, without judicial proceedings (where required), without satisfaction of other conditions precedent or procedural requirements in the mortgage itself or in applicable state law), does not always give the holder of the mortgage the legal ability to foreclose on the mortgage. Though a discussion of the other necessary prerequisites to foreclosure is beyond the scope of this paper, the fact that other steps may need to be taken by the owner of a mortgage note, or the owner of a mortgage, is neither unique nor surprising in our legal and regulatory system and does not diminish an otherwise legally effective transfer of the mortgage note and mortgage.

How Does the Use of MERS Affect These Issues?

The use of MERS as the nominee for the benefit of the trustee and other transferees in the mortgage loan securitization process has been a subject of litigation in recent years. See, e.g., Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623 (Mo. Ct. App. 2009). Some cases address the authority or ability of MERS or transferees of MERS to foreclose on a mortgage for which MERS is or was the mortgagee of record. See, e.g., Saxon Mort. Serv., Inc. v. Hillery, No. C-08-4357 EMC, 2008 WL 5170180, at *4-5 (N.D. Cal. Dec. 9, 2008). As a general matter, the assignment and transfer of a mortgage to MERS as nominee of and for the benefit of the beneficial owner of the mortgage does not adversely impact the right to foreclose on the mortgage.

Decisions in many jurisdictions support this conclusion. See, e.g., In re Mortgage Elect. Registration Sys., Inc. (MERS) Litig., No. 2:09-md-2119, 2010 WL 4038788, at *8 (D. Ariz. Sept. 30, 2010) ("Plaintiffs have not cited any legal authority where the naming of MERS . . . was cause to enjoin a non-judicial foreclosure as wrongful."); Commonwealth Property Advocates, LLC v. Mortgage Elect. Registration Sys., Inc., No. 2:10-CV-340 TS, 2010 WL 3743643, at *3 (D. Utah Sept. 20, 2010) (MERS as nominee has authority to foreclose); Taylor v. Deutsche Bank Nat'l Trust Co., No. 5D09-4035, 2010 WL 3056612, at *3 (Fla. App. Aug. 6, 2010) ("[T]he written assignment of the note and mortgage from MERS to Deutsche Bank properly transferred the note and mortgage. . . . The transfer, moreover, was not defective by reason of the fact that MERS lacked a beneficial ownership interest in the note at the time of the assignment, because MERS was lawfully acting in the place of the holder and was given explicit and agreed upon authority to make just such an assignment."); Mortgage Elect. Registration Sys., Inc. v. Bellistri, No. 4:09-CV-731 CAS, 2010 WL 2720802, at *15 (E.D. Mo. July 1, 2010) ("[a]s the nominee of the original lender … or the lender's assigns, MERS has bare legal title to the note and deed of trust securing it, and this is sufficient to create standing" to initiate foreclosure proceedings); Silvas v. GMAC Mortgage, LLC, No. CV-09-265-PHX-GMS, 2009 WL 4573234, at *8 (D. Ariz. Jan. 5, 2010) (MERS empowered to foreclose where MERS is designated on deed of trust as beneficiary); Diessner v. Mortgage Elec. Registration Sys., 618 F. Supp. 2d 1184, 1187-91 (D. Ariz. 2009) (MERS and trustee under deed of trust are authorized to institute non-judicial foreclosure proceeding); Jackson v. Mortgage Elec. Registration Sys., Inc., 770 N.W.2d 487, 501 (Minn. 2009) (rejecting argument that transfer of mortgage note to MERS is a transfer that must be recorded before foreclosure); Reynoso v. Paul Financial, LLC, No. 09-3225 SC, 2009 WL 3833298, at *2 (N.D. Cal. Nov. 16, 2009) (naming of MERS as initial beneficiary under deed of trust, as nominee for the lender, and the subsequent transfer of the deed of trust from MERS to a transferee was effective and did not hinder transferee's right to foreclose); Blau v. America's Servicing Co., No. CV-08-773, 2009 WL 3174823, at *8 (D. Ariz. Sept. 29, 2009) (MERS authorized under deed of trust to act on behalf of lender and transfer its interests); Farahani v. Cal-Western Recon. Corp., No. 09-194, 2009 WL 1309732, at *2-3 (N.D. Cal. May 8, 2009) (MERS authorized to pursue non-judicial foreclosure action); Vazquez v. Aurora Loan Servs., No 2:08-cv-01800-RCJ-RJJ, 2009 WL 1076807, at *1 (D. Nev. Apr. 20, 2009) (loan documents sufficiently demonstrate MERS' standing "with respect to the loan and the foreclosure"); Pfannenstiel v. Mortgage Elect. Registration Sys., Inc., No. CIV S-08-2609, 2009 WL 347716, at *4 (E.D. Cal. Feb. 11, 2009) (dismissing plaintiff's claim that MERS lacked authority to foreclose); Trent v. Mortgage Elect. Registration Sys., Inc., 288 Fed. App'x 571, 572 (11th Cir. 2008) (MERS "has the legal right to foreclose on the debtors' property" and "is the mortgagee"); Peyton v. Recontrust Co., No. TC021868, Notice of Ruling, at 2 (Cal. Super. Ct. County of Los Angeles S. Cent. Dist. Oct. 15, 2008) (MERS may foreclose under California law); Johnson v. Mortgage Elect. Registration Sys., Inc., 252 Fed. App'x 293, 294 (11th Cir. 2007) (summary judgment for MERS on its action for foreclosure of plaintiff's property); In re Smith, 366 B.R. 149, 151 (Bankr. D. Colo. 2007) (MERS has standing to conduct foreclosure on behalf of the beneficiary); Mortgage Elect. Registration Sys., Inc. v. Revoredo, 955 So.2d 33, 34 (Fla. Dist. Ct. App. 2007) ("Because, however, it is apparent – and we so hold – that no substantive rights, obligations or defenses are affected by use of the MERS device, there is no reason why mere form should overcome the salutary substance of permitting the use of this commercially effective means of business."); Mortgage Elect. Registration Sys., Inc. v. Ventura, CV054003168S, 2006 WL 1230265, at *1 (Conn. Super. Apr. 20, 2006) (MERS is proper party in foreclosure).

There are several minority decisions that, in some form, have taken issue with MERS. But none of these decisions, to our knowledge, has invalidated a mortgage for which MERS is the nominee, and none of these decisions has challenged MERS' ability to act as a central system to track changes in the ownership and servicing of loans:[22] See Rinegard-Guirma v. Bank of Am., Nat'l Ass'n, No. 10-1065-PK, 2010 WL 3945476, at *4 (D. Or. Oct. 6, 2010) (suggesting that MERS may not qualify as a legitimate beneficiary of a deed of trust under Oregon law, and preliminarily enjoining foreclosure action by MERS); In re Allman, No. 08-31282-elp7, 2010 WL 3366405, at *10 (Bankr. D. Or. Aug. 24, 2010) (same); Mortgage Elec. Registration Sys., Inc. v. Saunders, 2 A.3d 289, 297 (Me. 2010); In re Box, No. 10-20086, 2010 WL 2228289, at *5 (Bankr W.D. Mo. June 3, 2010) (finding that MERS, as beneficiary and nominee under the deed of trust lacked authority to assign the mortgage note because it never "held" the note itself);[23] In re Hawkins, No. BK-s-07-13593-LBR, 2009 WL

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[22] Some investors and loan servicers have sought to lessen the risk of challenges to foreclosure pertaining to MERS by assigning loans out of MERS and to the note holder prior to the initiation of foreclosure.

[23] The Court in In re Box expressly noted, but did not decide, the question of whether MERS had authority to assign the note as an agent of the lender or even as "a nominee beneficiary." In re Box, 2010 WL 2228289 at *4. The same court, in a later case, answered the question directly and found that MERS, as the designated "nominee for the lender and its assigns," "was the agent for [the lender] under the Deed of Trust from the inception, and MERS became agent for each subsequent note-holder under the Deed of Trust when each such note holder negotiated the Note to its successors and assigns." In re Tucker, No. 10-61004, 2010 WL 3733916, at *6 (Bankr. W.D. Mo. Sept. 20, 2010) ("[w]hen [note-holder] acquired the right to enforce the Note as the note-holder, MERS held the beneficial interest in the Deed of Trust on behalf of [note-holder] and [note-holder] had the right to enforce all the rights granted to [the original lender] and its successors and assigns in the Deed of Trust"). Thus, the Court found that the Note and the Deed of Trust were not split because of MERS' status as agent for the note holders. Id.

901766, at *3 (Bankr. D. Nev. Mar. 31, 2009) (finding that MERS was not a true "beneficiary" under a deed of trust, that, under the UCC, MERS was not entitled to enforce the note, and that "[i]n order to foreclose, MERS must establish there has been a sufficient transfer of both the note and deed of trust, or that it has authority under state law to act for the note's holder").[24]

Finally, it is important to recognize that the UCC does not displace traditional rules of agency law. See UCC § 1-103(b) ("Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law [of] . . . principal and agent . . . supplement its provisions."); see also UCC § 9-313 cmt. 3 (principles of agency apply for purposes of determining "possession" under Article 9). Under general agency law, an agent has authority to act on behalf of its principal where the principal "manifests assent" to the agent "that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act." Restatement (Third) of Agency § 1.01 (2006). Accordingly, the UCC does not prevent MERS or others, including loan servicers, from acting as the agent for the note holder in connection with transfers of ownership in mortgage notes and mortgages. See, e.g., In re Tucker, No. 10-61004, 2010 WL 3733916, at *6 (Bankr. W.D. Mo. Sept. 20, 2010) (finding MERS was the "agent for [the lender] under the Deed of Trust from the inception, and MERS became the agent for each subsequent note-holder under the Deed of Trust when each such note holder negotiated the Note to its successor and assign"); King v. Am. Mortgage Network, Inc., No. 1:09CV162 DAK, 2010 WL 3516475, at *3 (D. Utah Sept. 2, 2010) (rejecting argument that note and deed of trust were split because Fannie Mae held the note and MERS was listed as the nominal beneficiary under the deed of trust and finding that both MERS and the authorized loan servicer had authority as agents of the note holder to act on behalf of the note holder, including the initiation of foreclosure proceedings on the underlying property); Mich. Comp. Laws § 600.3204(1)(d) ("The party foreclosing the mortgage is either the owner of the indebtedness or of an interest in the indebtedness secured by the mortgage or the servicing agent of the mortgage."); Hilmon v. Mortgage Elect. Registration Sys., Inc., No. 06-13055, 2007 WL 1218718, at *3 (E.D. Mich. Apr. 23, 2007); Caravantes v. California Reconveyance Co., No. 10-cv-1407-IEG (AJB), 2010 WL 4055560, at *9 (S.D. Cal. Oct. 14, 2010) ("as servicer of the subject loan in this case, JP Morgan had the authority to record the Notice of Default and to enforce the power of sale under the Deed of Trust"); Birkland v. Silver State Fin. Servs., Inc., No. 2:10-CV-00035-KJD-LRL, 2010 WL 3419372, at *3 (D. Nev. Aug. 25, 2010) ("MERS, as nominee on a deed of trust, is granted authority as an agent on behalf of the nominator (holder of the promissory note) as to the administration of the deed of trust, which would include substitution of trustees"). In short, principles of agency law provide MERS and loan servicers another legal basis for their respective roles in the transfer of mortgage notes and mortgages.

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[24] Some parties to litigation, and commentators, have relied upon the Kansas Supreme Court's decision in Landmark National Bank v. Kesler, 216 P.3d 158 (Kan. 2009), to support the proposition that the identification of MERS as a nominee on a mortgage is improper. However, reliance on the decision in Kesler for that proposition is misplaced and stretches the decision well-beyond its actual holding. In Kesler, the Court merely held that MERS, in its capacity as the nominee for the lender under a second-position mortgage, was not entitled to notice of a foreclosure sale by the holder of the senior mortgage. See id. at 169-70. As the Kansas Appeals Court that considered the case noted, "[w]hether MERS may act as a nominee for the lender, either to bring a foreclosure suit or for some other purpose, is not at issue…." Landmark Nat'l Bank v. Kesler, 192 P.3d 177, 180 (Kan. Ct. App. 2008).

4. Conclusion

In summary, the longstanding and consistently applied rule in the United States is that, when a mortgage note is transferred, "the mortgage follows the note." When a mortgage note is transferred and delivered to a transferee in connection with the securitization of the mortgage loan pursuant to an MBS pooling and servicing agreement or similar agreement, the mortgage automatically follows and is transferred to the mortgage note transferee, notwithstanding that a third party, including an agent/nominee entity such as MERS, may remain as the mortgagee of record. Both common law and the UCC confirm and apply this rule, including in the context of mortgage loan securitizations. The legal principles and processes discussed above provide for – and, if followed, result in – a valid and enforceable transfer of mortgage notes and the underlying mortgages. The transfer and legal effectiveness of mortgage notes and mortgages are not diminished by the fact that the enforceability of mortgages, including the right to foreclose, is subject to the conditions precedent and requirements that are set forth in the particular mortgage itself and in the laws of the state in which the mortgaged property is located.

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