

## **SIFMA Q&A Regarding Mortgage Loan Transfers and Securitization**

**October 20, 2010**

SIFMA has prepared this informational document in order to address a number of basic questions regarding aspects of the mortgage loan secondary market and securitization process. SIFMA rejects sweeping claims that fundamental flaws regarding the transfer and ownership of mortgage loans are endemic to secondary markets and mortgage securitization, and believes that such concerns are exaggerated and without merit. While each situation may have variations, SIFMA believes that the customary practices utilized in secondary markets to convey ownership of mortgage loans from originators to other parties, and into securitization trusts, are sound and in accordance with generally applicable legal principles.

**Q. Please explain the recent press reports that question the validity of residential mortgage loan transfers into mortgage backed securities.**

**A.** These claims generally arise in the context of contested foreclosures. While most of the concerns that have been raised pertain to the technical process of filing for judicial foreclosure, some concerns relate to whether the loan servicer or loan holder is the proper party to bring the foreclosure action. In other words, the question is not whether the borrower defaulted under the loan documents for which foreclosure is a permissible or proper remedy. Rather, the question is whether the party filing the foreclosure documents has sufficient authority to bring the foreclosure action against the borrower and the home.

**Q. How could there be a question whether the loan holder has the right to enforce the mortgage loan documents?**

**A.** The question could arise where the original loan is sold one or more times in the capital markets before the loan is securitized or resecuritized. Parties may question who is the final holder of the loan at the time the loan is in default and subject to foreclosure. The rightful owner of the loan with the authority to enforce the mortgage loan documents may not be the original creditor on the mortgage loan documents.

**Q. How have borrowers challenged the ownership of loans?**

**A.** There are two principal challenges. The first is that some of the paperwork regarding the transfers of the loans has been lost or is incorrect or incomplete, and the paperwork needs to be cleaned up before the foreclosure can be finalized. The second is that the standard conveyance process used for the sale of the loans is insufficient to transfer ownership of the loans.

**Q. Does the challenge based on missing or mistakes in the loan documents have merit?**

**A.** It is certainly possible that from time to time there are unintentional errors in paperwork that may have to be corrected on individual loans. At the same time, these transfers typically are accompanied by clear contract language and intent conveying the seller's ownership interest in

the loan to the note holder. This means that, generally speaking, the loan holder owns the loan, but the loan holder may need to reconcile or supplement the paperwork to demonstrate its right to foreclose on the loan documents.

**Q. What is the standard process for transferring ownership of mortgage loans to a securitization vehicle?**

- A.** A mortgage loan is comprised of two primary elements: (i) a promissory note executed by the borrower "to the order of" the lender to evidence the borrower's obligation to repay the mortgage loan indebtedness, and (ii) a deed of trust, mortgage or other security instrument executed by the borrower to secure the repayment obligations under the promissory note by the borrower's ownership interest in a home. What distinguishes residential mortgage loans from others types of consumer credit is the right of the loan holder to foreclose on the loan documents and to acquire the borrower's ownership to the mortgaged home following a borrower's default. State laws govern the requirements for transferring ownership of residential mortgage loans and foreclosing on defaulted mortgage loans.

Mortgage loan securitization agreements customarily provide explicit language providing for the sale, transfer, conveyance and assignment by the transferor to the transferee of all of the transferor's right, title and interest in and to a defined pool of residential mortgage loans that are identified on a schedule. This general conveyance is often supplemented by specific actions with respect to each individual mortgage loan. First, the present holder would endorse the promissory note in blank, such as "pay to the order of \_\_\_\_\_" and then deliver the endorsed note either directly to the transferee or to a document custodian that holds the note on behalf of the transferee. Second, the transferor might also deliver an assignment of the mortgage, deed of trust or security instrument in blank (*i.e.*, without a designated assignee) in recordable form but unrecorded.

Most securitization documents require the trustee or a document custodian to review the submitted mortgage loan documents and notify the loan seller if all required loan documents are not received. The failure to provide the required documents could constitute a breach of the sale agreement and permit the trustee to exercise contract remedies. These provisions act as a check to ensure the securitization trust obtains proper ownership of the loans.

**Q. What is MERS and where does it fit in to the question of how loans are transferred?**

- A.** "MERS" is a corporation named Mortgage Electronic Registration Systems, Inc. According to its website, "MERS was created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper." MERS accomplishes this goal, in part, by acting as the nominee of the lender and its assignees in the local land records on mortgages and deeds of trust securing residential property in the United States. Thus, MERS remains the nominal mortgagee "no matter how many times servicing is traded." To eliminate the need for assignments of mortgages, originating lenders may close loans using standard security instruments containing language approved by Fannie Mae and Freddie Mac which name MERS as "Original Mortgagee." Alternatively, lenders may also assign loans into MERS if the loan has already been closed in the lender's name, by filing an assignment to MERS in the local land records. Once the loan is assigned to MERS, tracking servicing and beneficial rights can occur electronically for all future transfers. The need for any additional recorded assignments to reflect subsequent transfers of the mortgage loan will be eliminated, unless the servicing rights are sold to a non-MERS member, because MERS remains the nominal mortgagee in the local land records no matter how many times servicing is traded. MERS as original mortgagee (MOM) is approved by Fannie Mae, Freddie Mac, Ginnie Mae, FHA and VA. MERS is owned by several financial institutions; collectively, Fannie Mae and Freddie Mac own about 30% of MERS. .

**Q. How has the standard method of transferring ownership of loans been challenged?**

- A. A borrower's challenge of a loan holder's ownership of the borrower's mortgage loan generally arises as an attempt to prevent foreclosure. Some have claimed that a note endorsed in blank and delivered to the holder is insufficient to transfer ownership to the note, that the endorsement must be completed to the order of the transferee prior to delivery. Others have claimed that the sale and delivery of the promissory note does not convey title to the underlying mortgage automatically, but that a separate recorded assignment of the mortgage in the name of the transferee must be delivered to the loan holder itself. Some have claimed that recording the assignment in the name of a nominee, such as the loan servicer or MERS, for the benefit of the note holder is not sufficient.

**Q. Is an assignment "in blank" sufficient?**

- A. Modern real estate finance law and the model uniform commercial code generally recognize that the delivery of a promissory note endorsed in blank accompanied by an assignment in blank in recordable form but unrecorded in the local land records is sufficient to transfer ownership of a residential mortgage loan. Indeed, this is the process most often used by Ginnie Mae, Fannie Mae and Freddie Mac in their respective mortgage-backed securities programs and by many if not most private mortgage-backed securities programs.

**Q. Do challenges to the standard methods of transferring ownership of loans have merit?**

- A. The standard transfer processes described above generally are sufficient under applicable state law to transfer ownership interest in the mortgage loan to the transferee, including for the purposes of securitization.

It is, of course, difficult to broadly draw general conclusions about all transactions without knowledge of the specific terms of each. There may be some state law variations, and an owner may face certain risks as a result of failing to record an assignment (e.g., not receive notice sent to the lien holder of record) and additional requirements may apply in order to complete foreclosure. We note that courts generally have rejected legal challenges to MERS. In addition, investors, including Fannie Mae and Freddie Mac, have accepted these means of transferring ownership and Ginnie Mae has guaranteed mortgage-backed securities with the full faith and credit of the United States in reliance on such a process.

In addition to variations in laws, there can be variations in practices. Based on the instructions of the applicable investor, it is possible that the transferor would endorse the delivered promissory note to the order of a specifically identified transferee, such as to the trustee on behalf of the trust that issued the mortgage backed securities. In many states, assignments of mortgage are not required at all and the parties in their discretion may elect to use assignments anyway or they may not. It is also possible that the transferor might fill in the name of the assignee on the assignment of mortgage, and then record the assignment in the local land records. Alternatively, record title to the mortgage in the local land records also could be retained by the loan servicer to facilitate the servicing of the loan.

**Q. If these challenges do not have merit, why do they continue to be raised?**

- A. In the case of contested foreclosures, the claim probably is made to try to prevent a home foreclosure of a defaulted borrower who does not qualify for a loan modification or other loss mitigation alternative. There may be a variety of motivations of those who more generally claim that securitization trusts do not own the underlying residential mortgage loans, including the desire to generally delay foreclosures. We can say that we believe this broad brush claim is lacking merit.