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EXPERT ANALYSIS

MERS: A Primer

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In the aftermath of the savings and loan crisis, Mortgage Electronic Registration Systems Inc. was created in 1993 to track ownership interests in residential mortgages. The system was developed to allow for more efficient transfers of mortgages. MERS does not originate, lend, service or invest in home mortgage loans. Instead, MERS members can assign mortgage loans within the MERS tracking system without immediately recording each transfer in local land recording offices. MERS members consist of mortgage lenders and other entities. Members subscribe and pay a membership fee to MERSCORP Holdings Inc. — the parent company of MERS and the entity that owns the system — for the electronic processing and tracking of the ownership and transfers of mortgages.

By 2012, more than 70 million residential mortgages had been entered in the MERS database and more than 60 percent of new residential mortgages had been registered to the database.[1] While lawsuits across the country have attacked the use of MERS, most courts have upheld the validity of notes and mortgages within the system. This commentary explains how MERS works, addresses its development and purpose, delves into more recent challenges leveled by borrowers against the system and tackles the issue of MERS' standing to foreclose in the non-judicial foreclosure context.

MERS AS LENDER NOMINEE AND STREAMLINER

The primary market in the mortgage industry consists largely of consumer mortgage loans. These loans are usually evidenced by a promissory note and secured by a mortgage. A promissory note is a contract whereby the borrower promises to repay the loan to the lender, whereas a mortgage gives the lender the right to foreclose on the property if the borrower defaults on the loan obligation.

When a MERS member originates a new mortgage, the promissory note is made payable to the individual lender but the mortgage names MERS as nominee for that lender. The mortgage will typically include language such as the following: "Mortgage Electronic Registration Systems Inc. ('MERS'), a Delaware corporation, acting solely as nominee for lender and its successor and assigns."

After origination, lenders may sell mortgage loans on the secondary market to investors such as Fannie Mae and Freddie Mac. The loans may then be sold several more times or bundled into mortgage-backed securities. When the same mortgage is assigned multiple times, delay and chain-of-title problems may occur.

MERS streamlines the assignment process. A loan held by a member is registered in the MERS database and given a unique 18-digit "Mortgage Identification Number." Once the loan is registered, MERS serves as the mortgagee of record for all loans in its system. When the mortgage is recorded, the local land records list MERS as the mortgagee.

Naming MERS as the mortgagee of record allows members to transfer an interest in a mortgage loan to another MERS member. MERS privately tracks the assignment within its system and remains the mortgagee of record. Consequently, MERS members need not record assignments with local land recording offices each time they transfer a loan. The MERS system is consistent with the primary purpose of state recording statutes, which is to protect subsequent purchasers.[2] Subsequent purchasers are provided with notice that a MERS member holds a mortgage on the property. In short, "MERS administers an electronic registry to track the transfer of ownership interests and servicing rights in mortgage loans."[3]

This streamlining of the mortgage assign-ment process takes place only if the transfer is between two MERS members. If a MERS member transfers an interest in a mortgage loan to a non-member, MERS no longer acts as the mortgagee of record. Instead, an assignment of the security instrument to the non-member typically must be recorded in the local land recording office.

When an assignment must be recorded, MERS does not draft or execute the paperwork. Rather, it instructs its members to have someone on their own staff become a certified MERS officer with authority to sign on behalf of the system. When this instruction is followed, members that own the indebtedness can assign or foreclose the mortgage loan in the name of MERS.

Courts across the country have approved the MERS practice of assigning mortgages in its capacity as the lender's nominee.[4]

By 2012, more than 70 million residential mortgages had been entered in the MERS database.

MERS DOES NOT 'SPLIT' THE NOTE

If a borrower defaults on a note, the lender may initiate foreclosure in its own name. Alternatively, it may appoint a trustee to initiate foreclosure on its behalf. To have the legal authority to foreclose, the note and mortgage must be held together. This is because the holder of the note is entitled to repayment but does not have a right under the mortgage to use the property as a means of satisfying repayment. Conversely, the mortgage holder alone does not have a right to repayment and thus does not have an interest in foreclosing on the property to satisfy repayment.

Several borrowers facing foreclosure have argued that the MERS system impermissibly "splits" the note and mortgage by facilitating the transfer of the beneficial interest in the loan among lenders while maintaining MERS as the nominal holder of the mortgage. Many courts have rejected this argument, finding that the notes and mortgages were not irreparably split.

For example, in *Cervantes v. Countrywide Home Loans*, borrowers attempted to bring a class action challenging the validity of MERS procedures.[5] The borrowers each took out loans secured by their residences, defaulted on the loans and were subjected to foreclosure. In their lawsuit, they argued that all transfers of the interests in the residential loans within the MERS system were invalid because the designation of MERS as a beneficiary split the mortgage from the note. The borrowers claimed that as a result, no party was in a position to foreclose.

The court found that even if MERS was a sham beneficiary, the system was not the party that initiated the foreclosure. It held that the lenders would still be entitled to repayment and would be the proper parties to initiate foreclosure procedures. The court further held that the note and deed were not irreparably split, explaining that the split would render the mortgage unenforceable only if MERS was not an agent of the lender. The borrowers made no such allegation.

Likewise, in *Bucci v. Lehman Bros. Bank*, borrowers obtained a loan from Lehman Brothers to finance the purchase of their home.[6] They also executed a mortgage on the property to MERS as nominee for Lehman. The borrowers ceased making loan payments. In defense of the foreclosure action filed against them, they alleged that MERS held legal title to the mortgage but not the note. The borrowers cited statutes and case law to support their position that there must be unity in the note holder and mortgagee.

The court acknowledged that when most of the relevant statutes were enacted, the mortgagee and note holder were almost always the same entity. It also recognized that "[i]n the modern world of lending, however, that is no longer the case."[7] The court thus confronted the problem of attempting to "shoehorn" a modern system of commerce into legal categories that stemmed essentially from medieval English land law. Noting the feudal roots of the statutes, the court refused to construe them to preclude MERS from acting as a nominee on behalf of the note holder.

In another case in which MERS was designated as a beneficiary of a deed of trust but not the holder of the note, the Nevada Supreme Court declined to find such a split irreparable. The court said: "Rather, '[a]ssuming *arguendo*, that there was a problem created by the physical separation of the security deed from the note, that problem vanishe[s]' when the same entity acquires both the security deed and the note. Indeed, while entitlement to enforce both the deed of trust and the promissory note is required to foreclose, nothing requires those documents to be unified from the point of inception of the loan."[8]

Consequently, MERS may later assign its beneficial interest in the deed of trust to the holder of the note, at which time the documents are reunified and the holder of the deed and note may institute foreclosure proceedings.

MERS members need not record assignments with local land recording offices each time they transfer a loan.

Borrowers may continue to challenge a foreclosure action by arguing the use of MERS impermissibly splits the note from the mortgage, but existing case law provides little support for this position.

MERS STANDING IN NON-JUDICIAL FORECLOSURES

Borrowers may also attempt to attack the use of MERS in non-judicial foreclosures. A judicial foreclosure is a court proceeding whereby a lender files a complaint describing the debt, the borrower's default and the amount owed. In these cases, "[t]he complaint asks the court to allow the lender to foreclose its lien and take possession of the property as a remedy for non-payment."[9]

In a non-judicial foreclosure, there is no court intervention. When the default occurs, the borrower is mailed a default letter. The borrower may make payments to become current on his loan during a prescribed period. If he does not, a notice of sale is mailed to the borrower, posted in public places, recorded at the county recorder's office and published in area newspapers and legal publications. After the legally required notice period expires, the property is sold at auction to the highest bidder. Borrowers may attempt to block a trustee's sale by filing a lawsuit to enjoin it. In a non-judicial sale, the swiftness of the proceedings and lack of judicial oversight make it paramount that the mortgagee has established its authority to foreclose.

The majority of courts have found that MERS has standing to foreclose in a non-judicial foreclosure proceeding. For example, in *Residential Funding Co. v. Saurman*, the Michigan Supreme Court reversed an intermediate appellate court's finding that MERS lacked the authority to foreclose because it was not the note holder.[10] The court held, "Under the settled law of this State, the mortgage and the note are to be construed together."[11] It emphasized that courts have never required that a mortgage be given directly to the beneficiaries. Consequently, the court held that since MERS was the undisputed record holder of the mortgage, it had the authority to foreclose.

In *Niday v. GMAC Mortgage*, the court addressed whether MERS and its members could avail themselves of Oregon's non-judicial foreclosure process for trust deeds.[12] The borrower had executed a trust deeds that named MERS as the beneficiary. After the borrower defaulted, she received a notice of trustee's sale that identified MERS as the "beneficiary" of the sale and asserted a power of sale under the trust deed. The borrower then filed a declaratory judgment action arguing that MERS was not the beneficiary of the trust deeds for purposes of Oregon's non-judicial foreclosure laws.

The court held that the "beneficiary" of the trust deed under the Oregon Trust Deed Act is the person to whom the underlying loan repayment obligation is owed. Because the trust deed in this case designated GreenPoint Mortgage Funding as the lender, the court found GreenPoint (and not MERS) had the power to foreclose.

More importantly, evidence in the record established that GreenPoint had assigned its interest in the trust deed without recording the assignment. The court declared, "A beneficiary that uses MERS to avoid publicly recording assignments of a trust deed cannot avail itself of a nonjudicial foreclosure process that requires that very thing — publicly recorded assignments."

Prior to foreclosing in non-judicial foreclosure states, lenders should first ensure that the chain-of-title is updated and confirm that status of that jurisdiction's laws regarding MERS' ability to foreclose in its role as nominee.

CONCLUSION

Courts across the country have approved the MERS practice of assigning mortgages in its capacity as the lender's nominee.

While the MERS system alleviates many of the problems that existed prior to its inception (*i.e.*, the excessive paperwork, the confusion of multiple assignments and the delays in local recording offices), litigants continue to challenge the validity of the system. Given the increase in MERS-held mortgages, challenges will continue to be asserted by borrowers in defense to foreclosure proceedings, both judicial and non-judicial.

Nonetheless, case law exists in many, if not most, jurisdictions to support striking down such challenges. Prudent lenders should confirm the status of the applicable jurisdiction's case law impacting mortgages held within the MERS system prior to initiating a foreclosure action.

NOTES

[1] Zachary A. Kisber, *Reevaluating MERS in the Wake of the Foreclosure Crisis*, 42 Real Est. L.J. 183 (2013).

[2] *Rowe v. Small Bus. Admin.*, 446 N.E.2d 991, 993 (Ind. Ct. App. 1983) ("We believe the case law clearly establishes that the recording pro-visions of I.C. 32-8-11-1 were enacted to protect subsequent purchasers and mortgagees."); *Chrysler Credit Corp. v. Burton,* 599 F. Supp. 1313, 1318 (M.D.N.C. 1984) ("The purpose of North Carolina's recording statute is to enable intending purchasers and encumbrancers to rely with safety on the public record concerning the status of land titles.").

[3] *In re Huggins,* 357 B.R. 180, 183 (Bankr. D. Mass. 2006).

[4] *See Blau v. America's Servicing Co.,* No. CV-08-773-PHX-MHM, 2009 WL 3174823, *8 (D. Ariz. Sept. 29, 2009) (finding that, under an agency theory, MERS was authorized to transfer the lender's interest); *HSBC Bank USA v. Keenhold,* No. 4:CV-08-1024, 2009 WL 523092, *2 (M.D. Pa. Mar. 2, 2009) (acknowledging that MERS, as nominee to the lender, had assigned the promissory note and mortgage); *Sicairos v. NDEX West LLC,* No. 08-CV-2014-LAB (BLM), 2009 WL 385855, *2 (S.D. Cal. Feb. 13, 2009) (acknowledging that MERS, as nominee of the lender transferred the interest in the plaintiff's deed to the defendant); *In re Huggins,* 357 B.R. at 182 (finding that MERS, as the nominee mortgagee, and under the express terms of the mortgage, has full mortgage rights with respect to the property at issue).

[5] *Cervantes v. Countrywide Home Loans,* 656 F.3d 1034, 1037 (9th Cir. 2011).

[6] *Bucci v. Lehman Bros. Bank,* 68 A.3d 1069, 1072 (R.I. 2009).

[7] *Id.* at 1086.

[8] *Edelstein v. Bank of N.Y. Mellon,* 286 P.3d 249, 259 (Nev. 2012) (quoting *In re Corley,* 447 B.R. 375, 384–85 (Bankr. S.D. Ga. 2011)).

[9] Mortgage Bankers Ass'n, Judicial Versus Non-Judicial Foreclosures http://www.mbaa.org/files/ResourceCenter/ForeclosureProcess/JudicialVersusNon-JudicialForeclosure.pdf.

[10] *Residential Funding Co. v. Saurman,* 490 Mich. 909 (Mich. 2011).

[11] *Id.* (quoting *Guardian Depositors Corp. v. Wagner,* 287 Mich. 202, 208 (Mich. 1939)).

[12] *Niday v. GMAC Mortgage,* 251 Or. App. 278, 280-81 (Or. Ct. App. 2012).


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