

MERS™ AND THE TITLE INDUSTRY

By: Lawrence C. Eisen
Northwest Area underwriter
Chicago Title Insurance Company

How will the Mortgage Electronic Registration Systems, Inc., commonly known as "MERS"™ affect the title industry? Will procedures in title and closing operations need modification now that MERS is operational?

Significant changes in mortgage lending have occurred over the last 25 years. Historically, most residential mortgages were made by banks, savings and loan associations, and local institutions which took in deposits from their customers and made loans in their own localities. Mortgages were kept on the bank or savings and loan's books and seldom sold. Fannie Mae was a relatively small organization dealing with FHA and VA loans. Mortgage backed securities did not exist. Mortgage bankers were a small force in the market.

With the savings and loan crisis and the growth of Fannie Mae and Freddie Mac, residential mortgage lending has changed. The mortgage banker dominates the industry. Mortgage bankers differ from banks and savings and loans by making loans on borrowed funds, assembling loan portfolios and selling them to investors including Fannie Mae and Freddie Mac. As the number of loans sold on the secondary market increased, investors chose not to service the loans in their portfolios. Investors began to contract with loan servicing companies to perform loan servicing functions. Presently, the lender who originates the loan frequently retains the servicing rights to the loan by contract after it sells the loan to an investor. Servicing rights comprise certain functions, e.g. processing payments, administering escrows for payment of property tax bills and hazard insurance premiums, handling foreclosures. These servicing rights

contracts can provide an annual revenue stream for the life of the loan. Servicing rights have significant value and can be sold separately. Servicing rights are a commodity traded by companies in this specialized business.

The modern residential mortgage industry features two secondary markets in revenue-producing assets: one for beneficial interests (the mortgage interests themselves, notes secured by liens on real estate), and another for service contracts. MERS provides a system for tracking both of these markets.

As the secondary market has evolved and matured and transactions become more numerous, a more efficient way of transferring and tracking ownership of mortgage rights had to be developed to replace the cumbersome and involved manner in which they were traded. MERS is the mortgage finance industry-owned effort to improve the residential mortgage market. MERS, in operation since Spring 1997, is a non-stock corporation owned by its members. The MERS *system* is an electronic book entry system for registering and tracking mortgage rights through a central loan data registry. The MERS system is modeled on the book entry system used in the securities industry to transfer interests in securities.

The MERS concept first emerged from an interagency task force composed of the Mortgage Bankers Association (MBA), Fannie Mae, Freddie Mac and Ginnie Mae. The stated purpose of the MERS concept was to reduce the costs involved in the transfer of servicing rights of mortgages, which would in turn reduce the costs of credit and increase the number of transactions in home purchasing and refinancing.

The real estate finance industry has made process and automation improvements that created efficiencies in originating and servicing loans. Transfers among lenders, investors, and mortgage servicing companies created new problems. Ownership and servicing rights were transferred by paper assignments that had to be prepared, verified and recorded. MERS evolved to cut costs and reduce errors by centralizing certain information that was otherwise scattered among closing documents, public land records and unrecorded mortgage assignments and service contracts.

How does MERS operate?

When a loan is originated, a traditional paper mortgage is recorded with the local recorder. Immediately after the recording of the mortgage, an assignment of the mortgage to MERS, prepared by the original lender, is recorded. MERS remains the mortgagee of record for the life of the loan. The loan can be registered with MERS by the lender at the time of origination, at closing, or at the time of assignment to MERS. At the time of registration of the loan in the MERS system, all of the supporting information for the loan will be captured. MERS then assigns an 18-digit Mortgage Identification Number (MIN) to the mortgage as a permanent identifier for the life of the loan.

The process of assigning mortgage rights creates a significant portion of servicing transfer costs. A large portion of these costs is the manual preparation and tracking of the mortgage rights. Many times in the transfer of mortgage rights, previous assignments are not found either of record or in the servicer's files. Mergers and consolidations of lending institutions have also caused problems in creating a chain of title for a mortgage or mortgage rights. In MERS, however, all subsequent assignments of MERS mortgage rights will be registered and maintained in the MERS system. There no longer will be a need to manually prepare, deliver, record and track assignments of mortgage rights.

What principles is MERS guided by?

MERS is guided by three general principles:

1) Every state provides a mechanism to secure loans by taking an interest in real estate granted by the property owner.

2) In every state there are certain designated places where mortgages must be recorded to be a valid lien against a bonafide purchaser: In Illinois, the office of the county recorder.

3) Every jurisdiction allows a person or corporation to appear as a title holder in the public records as a nominee for another person or corporation who is the true party in interest. See *American Bank and Trust Company vs. Louisiana Savings Association*, 386 So. 2d 96 (La. Ct. App. 1980), and *The Illinois Trust and Trustees Act* (760 ILCS 5/1 et seq.).

MERS is not an independent recordation system for mortgages. MERS has no authority to record mortgages under either state or federal laws. The Illinois Conveyances Act (765 ILCS 5/0.01 et seq.) requires that deeds, mortgages and other instruments relating to or affecting title to real estate in Illinois shall be recorded in the county in which the property is located and shall take effect and be in force from and after the time of filing the same for record, and not before, as to all creditors and subsequent purchasers without notice. The entire basis of the MERS system is the recording of the mortgage and the subsequent assignment to MERS in the local land records.

MERS does not intend to replace or replicate the current statutory requirements which guide the physical recording of land title documents. The MERS system is based on recorders maintaining their present statutory function. No changes in federal or state laws are necessary for the implementation of MERS. What is important is that MERS is bound by the law of the state where the property is located, just as any mortgagee would be.

Because MERS remains the mortgagee of record, any subsequent sales or transfers of mortgage rights will be reflected and tracked in the MERS electronic registry system. The MERS system provides a platform for mortgage servicing rights to be traded among its members. When servicing rights are traded from one servicer to another, the transfer is initiated through MERS by the old servicer and, once the transfer is confirmed by the new servicer, the MERS system is updated to reflect the new servicer as the proper holder of mortgage servicing rights. Note assignments are electronically registered in the same manner. MERS is a secure system with member access to information dependent on the member's relationship to a particular loan.

Prior to the use of the MERS system, each time a loan was sold on the secondary market it received a new identification number. Multiple loan numbers are a source of much confusion and can cause problems in tracking loans. The MIN, however, is a permanent identifier carried throughout the lifetime of the loan, regardless of who originated or currently owns the mortgage rights.

Now that MERS is operational, how will it affect the title professional?

Although the MERS system was not developed specifically for title insurers, it can provide significant quality control in searching, examining, and closing procedures.

1) Searching:

MERS could simplify the searching procedure. Once there is an assignment of record to MERS, except as stated below, there should be no subsequent activity of record during the life of the loan. The mortgage chain of title will not be broken by missing assignments of the mortgage. Mergers and consolidations will become irrelevant to the chain of title of a MERS mortgage. Attempting to obtain releases from companies that are out of business will no longer be a problem. The release will come from MERS, the mortgagee of record.

MERS will deregister a loan and place an assignment of record in the local land records when there is a note assignment or transfer of servicing rights from a MERS member to a non MERS member or if a MERS member decides to resign from MERS.

2) Examining:

The ALTA policy defines public records as “records established under state statutes at the date of policy for the purpose of imparting notice of matters relating to real property to purchasers for value without knowledge.” Currently a search will not be performed in the MERS system for the purpose of production of a title commitment.

If a title company is preparing a necessary parties commitment for real estate litigation (usually a mortgage foreclosure or tax deed petition), and MERS is found to be a subordinate mortgagee of record, MERS will be named as a party whose interest may

be eliminated by the proceeding. The holders of the note, if known or otherwise as unknown owners, should also be named. MERS as mortgagee of record will be responsible for any duties normally associated with a mortgagee under state law. MERS, as mortgagee of record, will receive service of legal process related to the property. MERS will look to the mortgage servicer to handle the litigation matters. MERS will designate a certifying officer at each servicer to handle a litigation matter on its behalf. MERS will maintain an electronic mailroom. If MERS receives a summons or any other notice, it will image the document and immediately electronically transmit the document to the current servicer.

When a MERS mortgage is in default and is to be foreclosed, MERS will be a nominal plaintiff. The registered servicer will actually conduct the litigation.

3) Closing or settlement:

Closing professionals will benefit from a centralized loan pay off information source. A search of the MERS system will reveal who is the current servicer of a loan. The MERS system will also provide an address and phone number for the current servicer. This will make it easier for the professional to contact the current servicer for obtaining the pay off letter. It will also allow the closing professional to verify that the loan pay off presented at a closing is coming from the right entity. This information will be available 24 hours a day. The recordable release of a paid mortgage will come from MERS.

Currently, you may contact MERS at:

MERS Inc.
8201 Greensboro Drive, Suite 350
McLean, Virginia 22102

Phone: (888) 679-MERS or (888) 679-6377

You may get further
information about MERS
at its web site
(www.mersinc.org).