

Community Blight and the Mortgage Crisis: Should MERS Help Clean Up the Mess?

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Abstract: This article addresses the controversial issue of foreclosed homes that are never maintained and fall into ruin. Mortgage Electronic Registration Systems, Inc. (MERS) handles around 60 percent of mortgages in the United States. It registers mortgage titles in its database so that when rights to a payment are sold or traded, investors do not need to register the mortgage over again. When a homeowner defaults, MERS can foreclose on the home or reassign the mortgage to the investor so the investor may foreclose. However, after the homeowners are kicked out, no one maintains the home. Because mortgage-backed securities were bundled into pools of mortgages, entire communities are depressed by homes in disrepair. Banks, investors, servicers, and MERS try to deny responsibility for the homes. The conclusion is that MERS cannot foreclose on a home and then waive responsibility for maintaining it throughout that process; however, if MERS limits itself to keeping records and leaves foreclosure to other parties in the process, it likely has no fiduciary duty to maintain homes.

What is MERS?

Mortgage Electronic Registration Systems, Inc. (MERS) is wholly owned by the private corporation MERSCORP Holdings, Inc., and serves as a mortgagee in public land records.¹ Established in 1998 by the mortgage banking industry,² MERS assumes the legal title to mortgages, while investors keep the actual promissory note (rights to payments made by homeowners) that is purchased from mortgaging banks or financial institutions. A mortgage is an interest in a house, secured by the title of the house, which is given to the mortgaging bank along with the promissory note. These are part of the same agreement; however, the financial institutions pool their mortgages together and sell the pool to an investor

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¹ "MERS: About Us," accessed June 27, 2012, www.mersinc.org/index.php/about-us/faq.

² Charles Taylor, "County recorders, registers of deeds: We're losing money to MERS," *NACo County News* 43:9 (2011), www.salemdeeds.com/pdf/NACo05-10-11.pdf.

as a residential mortgage-backed security (RMBS).³ Credit is an essential asset in any economy and may especially allow a capitalist economy to flourish. RMBS is very important in the extension of credit to individuals. It helps allocate money from investors to homebuyers via the lenders.

MERS helps facilitate this beneficial transaction. In at least 60 percent of these cases,⁴ the mortgage title is split from the promissory note, and the title is assigned to MERS while the investor keeps the promissory note. Over the course of a mortgage's existence, the promissory note is typically sold many times, from one investor to the next, creating numerous degrees of separation between the owner of the promissory note and MERS, the owner of the legal mortgage title.

How Does MERS Work?

MERS is essentially a data storage center where the ownership of promissory notes is supposed to be recorded with every new transfer between investors, tracking changes in mortgage servicing rights and promissory note holders.⁵ The idea is to centralize the process of RMBS deals so transactions and undisclosed liens may be found with ease,⁶ and constant filing may be avoided. While quickly locating transactions and liens is undoubtedly beneficial, another result is the avoidance of servicing fees. These lost fees are one of public land recording officers' largest complaints about MERS.⁷ As long as investors make transfers among fellow MERS members, MERS holds the title of "mortgagee-as-nominee" for the duration of the mortgage.⁸ Since the mortgagee remains in MERS, the need to re-file public records each time the promissory note is transferred is eliminated. Investors, lenders, banks, and others become members of MERS by paying an annual fee and consenting to the rules, terms conditions.⁹ MERS has only approximately 65 employees, who cannot keep up with day-to-day transactions (ranging from between 20 and 40 per day for one employee at a debt collection firm in Florida¹⁰). Therefore, MERS terms and conditions state

³ "Mortgage Securities," Securities and Exchange Commission, <http://www.sec.gov/answers/mortgagesecurities.htm>.

⁴ *Oratai Culhane v. Aurora Loan Services of Nebraska*, U.S. District Court of Massachusetts (28 November, 2011), p. 33.

⁵ "MERS: About Us."

⁶ *Id.*

⁷ *See* Taylor.

⁸ "MERS: Information for Homeowners," accessed on June 27, 2012, www.mersinc.org/index.php/information-for-homeowners/faq-information-for-homeowners.

⁹ *Culhane v. ALSN* at 33.

¹⁰ *Ibid.*, at 47.

that members must maintain records themselves by recording any activity involved with the mortgage;¹¹ however, MERS does not have any policing power over this expected function.

The real issue is what happens when a disinterested holder of legal title, such as MERS, works with an investor, who is largely separated from the reality facing the homeowner or home, in order to foreclose. When a mortgage default occurs and MERS and/or the investor wishes to foreclose on the home, the necessary procedure differs from state to state. In Massachusetts, MERS must assign the legal title to the investor holding the promissory note or obtain consent to foreclose on the note holder's behalf.^{12,13} Georgia courts similarly held that MERS does not have the capacity to unilaterally foreclose on a home.¹⁴ Counsel for MERS explained that MERS does not "provide any loan servicing functions whatsoever. MERS merely tracks the ownership of the lien."¹⁵ In Arizona, the idea of a split title is rejected and MERS is considered an "agent" of the promissory note holder.¹⁶ As an agent, MERS holds the mortgage title for the note holder and is empowered to act on the note holder's behalf.¹⁷ No further action is required in these states for MERS or the note holder to foreclose.

Which Entity is Responsible for the Home?

The likelihood of MERS foreclosing on homes has decreased since 2011, when the company suffered judicial reprimand in multiple court cases.¹⁸ Now more than ever, as counsel for MERS made clear, MERS simply maintains computer hard drives with mortgage title information but has no interest in the home or homeowner. MERS maintains the legal title but does not want to be

¹¹ "MERS: Information for Homeowners."

¹² *Culhane v. ALSN* at 39-42.

¹³ *Eaton v. Federal National Mortgage Association*, Supreme Judicial Court of Massachusetts, 462 Mass. 569, 579 (June 22, 2012).

¹⁴ *Rollins v. MERS*, Superior Court of Fulton County, Georgia, Case No. 2010-CV-192270, accessed July 1, 2012, www.msfraud.org/LAW/Lounge/rollins-v-mers-void-georgia-foreclosures.pdf.

¹⁵ *Ibid.*, quoting *Mortgage Elec. Reg. Sys., Inc. v. Nebraska Department of Banking*, 704 N.W. 2d 784, 787 (citing brief for MERS)

¹⁶ *In re Mortgage Electronic Registration Systems (MERS) Litigation*, MDL No. 09-2119-PHX-JAT, United States District Court of Arizona (May 25, 2012), p. 2-3. (WESTLAW 2012 WL 1912133).

¹⁷ *Id.*

¹⁸ John R. Hooge and Laurie B. Williams, "Mortgage Electronic Registration Syses, Inc.: Cases Decided in the Past Year Determining MERS's Authority to Act; or MERS – The Elephant in the Living Room," *Norton Bankruptcy Law Advisor* 10 (October 2011): 15-16.

caught holding the bill for maintenance. The other parties involved in the RMBS may be even further distanced than MERS.

In this scenario, the original mortgaging banks would have sold off their interest long ago to investors, who are also indifferent and only purchased an interest in the payments and/or foreclosure profits. Investors do not deal directly with homeowners; mortgage payments and foreclosures are overseen by a third-party agency that communicates with the homeowner on the investor's behalf and is the only entity to deal directly with the homeowner. The agency's only function is to ensure investors receive mortgage payments or to notify the homeowner of default, and the agency's only interest outside of keeping investors happy is to maximize profit, which largely comes from late fees.¹⁹ None of these parties has an obligation to the homeowner or the maintenance of the home and property after foreclosure. The original mortgage lender was paid long ago; the investor gets paid at time of foreclosure; and the oversight agency has no payment to oversee after foreclosure. These deals are included in RMBS pools containing numerous mortgages, so entire communities can be affected. The only connection between any of these parties and the home after foreclosure is the legal title to the home. At the time of foreclosure, even in states recognizing a split title, the title and note are united in order to foreclose. Therefore, either MERS or the promissory note holder holds the legal title to the home. This arrangement is maintained throughout the foreclosure period until a new homeowner is found.

Effects of Foreclosure

The effect of foreclosure on a homeowner can be life altering. "VantageScore Solutions, a credit scoring firm, estimates a 21 percent drop in one's credit score due to mortgage delinquency and subsequent foreclosure, given no other simultaneous delinquencies."²⁰ As if that weren't enough, depending on the state, investors may sue the homeowner if the sale of the house does not fully pay back the mortgage.²¹ When houses are foreclosed upon, the oversight agency stops at foreclosing and selling; no maintenance is performed. The state of the economy only makes this picture bleaker. "While historically residential mortgage defaults averaged about 1.7 percent from 1979 to 2006, defaults jumped to 4.5 percent by mid-2008."²² The lack of ethical standards played an even larger role

¹⁹ *Culhane v. ALSN* at 51-53 (Footnote 15).

²⁰ Neil Bhutta, Jane Dokko and Hui Shan, "The Depth of Negative Equity and Mortgage Default Decisions," p. 5 (May 2010), <http://www.federalreserve.gov/pubs/feds/2010/201035/201035pap.pdf>.

²¹ *Ibid.*, at 5-6.

²² Eric Arentson et al., "Subprime Mortgage Defaults and Credit Default Swaps," p. 1

in foreclosures for homeowners with poor prior credit history. These homeowners should not have been able to obtain the mortgages they received, and MERS and investors capitalized on transferring their titles (called “subprime mortgages”). From mid-2005 to mid-2008, the proportion of subprime mortgages in default rose from 5.6 percent to 21 percent.²³ With no one maintaining such a large percentage of homes after foreclosure, communities have suffered.

In some states, including Massachusetts and Georgia, many foreclosures in which MERS acted unilaterally may be deemed void. The Massachusetts Supreme Judicial Court made this clear in a 2011 case, which found that not even the promissory note holder could foreclose without joining the mortgage with the note.²⁴ These voided foreclosures only add to the problems communities face. According to agents in the Boston area, most of the bank-owned homes that were improperly foreclosed upon are uninsurable and thus unsellable.²⁵ This drastically increases the time a home is not maintained and the chances of dilapidation. According to MERS’ own website, “unmaintained vacant properties invite crime, depress home values and pose safety risks.”²⁶

Seeking those Responsible

Many people, including numerous state attorneys general, believe MERS ought to be the responsible party. As many see it, MERS claiming no involvement while simultaneously claiming they have all the rights of the investor to foreclose means that they want it both ways. Some attorneys general believe MERS has evaded responsibility for the welfare of communities and individual states by removing filing fees payable to the state.²⁷ MERS has evaded judicial invalidation by conforming strictly to most state statute requirements for secured transactions in RMBS; therefore, MERS is not at fault for the lost fees. Multiple states hope to change this, with Massachusetts Attorney General Martha Coakley leading the charge by filing a case on Dec. 1, 2011.²⁸ This suit also attacks the deceptive

(January 2012),
http://belkcollegeofbusiness.uncc.edu/ichiang1/seminars/downloads/2012S_Mauer.pdf).

²³ *Id.*

²⁴ *U.S. Bank National Association v. Ibanez*, Supreme Judicial Court of Massachusetts, 458 Mass. 637 (January 7, 2011).

²⁵ “Mers and Title Mess is an Issue That Likely Will Not Go Away,” *Financial Reality Revisited*, <http://financialrealityrevisited.blogspot.com/2011/03/mers-and-title-mess-is-issue-that.html>.

²⁶ “MERS: iRegistration Flyer,” accessed June 27, 2012,
www.mersinc.org/component/docman/doc_download/8-flyer-1?Itemid=.

²⁷ *Culhane v. ALSN* at 54-55 (Footnote 15).

²⁸ Gretchen Morgenson, “Massachusetts Sues 5 Major Banks Over Foreclosure Practices,”

practices of the servicers (oversight agencies) and major banks, and the main thrust at MERS is for “corrupting” the public land recording system.²⁹ There are multiple problems throughout the foreclosure process, but the most questionable are the resulting demoralized communities and the global financial effects. MERS moves to foreclose homes often but denies any fiduciary duty to the homes once foreclosed. The question then becomes whether MERS has a fiduciary duty to the maintenance of the homes it forecloses upon, and if not, does the investor?

The Duty to Maintain

In the legal community, this issue is largely considered a problem with the definition and self-designation of MERS as “mortgagee-as-nominee.” Courts nationwide dispute the fiduciary duties MERS owes as a “nominee.” Many states, including Georgia, do not define “nominee” in the context of secured real property.³⁰ The court opinions thus far in Arizona, Massachusetts, Georgia and other states suggest the best designation for MERS is a different self-imposed term: “agent.”³¹ Even in the role of “agent” for the promissory note holder, the fiduciary duty of MERS to the maintenance of foreclosed homes is unclear. MERS may simply be a record-keeper, with the principal promissory note holder the only responsible party. On the other hand, MERS may be far more than that. The company historically took a range of action from holding the legal title to initiating foreclosures and sales. This range may need to be properly and strictly defined to clearly outline MERS’ fiduciary duties. It seems the company itself is pushing a far more limited role³² than court cases would suggest existed: If MERS conducts itself as simply a record storage and tracking system, assigning the mortgage to the promissory note holder in instances of default and foreclosure, MERS should not bear the burden of a fiduciary duty beyond maintaining the records. However, if MERS is more than merely record keeper, foreclosing and holding onto mortgages throughout the home vacancies, MERS ought to have a larger duty to maintain the homes during the foreclosure period.

Many court cases are still in progress and have the potential to reach the Supreme Court of the United States given the widespread role MERS plays on the housing market. Many large banks, such as JP Morgan Chase, Bank of America,

The New York Times, December 1, 2011, accessed June 2, 2012,
<http://www.nytimes.com/2011/12/02/business/major-banks-face-new-foreclosure-suit.html>.

²⁹ *Id.*

³⁰ *Rollins v. MERS*.

³¹ *Rollins v. MERS; Eaton v. FNMA; In re MERS*.

³² “MERS: About Us.”

and Citigroup, offered settlements in 2011 to state attorneys general to help clean up the blight caused by the RMBS crisis.³³ MERS has largely stayed out of these dealings. Delaware, Nevada, New York, and Massachusetts objected to last year's proposed settlements as unfair and not close to meaningful relief.³⁴ Massachusetts led that charge by filing the complaint in state court; the state wants big banks and MERS to take full responsibility for the damage left in their wake. On March 12, 2012, 49 attorneys general signed a National Mortgage Settlement with the five major banks that serviced the mortgages.³⁵ Delaware, Nevada, New York, and Massachusetts all signed the settlement.³⁶ This \$25 billion settlement includes a minimum of \$17 billion that will go directly to homeowners and \$3 billion to an underwater mortgage refinancing program.³⁷ The banks will pay \$5 billion to the states and federal government as well.³⁸ States are still allowed to pursue civil and criminal claims outside of the agreement.³⁹ Attorney General Martha Coakley seems to think both the banks and MERS share responsibility for the blight.⁴⁰ This may very well be the case, since both parties may maintain interest in the homes during the foreclosure period.

In response to the lack of corporate responsibility, many towns and cities enacted property preservation contact information ordinances.⁴¹ These require property preservation contacts to be included with mortgages so the town knows who is responsible for maintaining vacated properties after foreclosure. Some of these municipalities even created their own vacant property databases to house this new information.⁴² MERS recognized the need to comply with jurisdictional requirements and the growing concern over community blight and responded by updating its online registration systems.⁴³ This new addition provides space for the registrant to enter property preservation contact information. MERS hopes this will be used like its main product – a central terminal to track information that is now required by jurisdictions – for all vacant properties. MERS made this particular database free for municipalities to access.⁴⁴ This demonstrates that

³³ See Morgenson.

³⁴ *Id.*

³⁵ “State Attorneys General, Feds Reach \$25 Billion Settlement with Five Largest Mortgage Servicers on Foreclosure Wrongs,” National Association of Attorneys General, *NAAG News*, accessed July 4, 2012, naag.org/state-attorneys-general-feds-reach-25-billion-settlement-with-five-largest-mortgage-servicers-on-foreclosure-wrongs.php.

³⁶ “State Attorneys General Who Signed the Joint State-Federal Mortgage Settlement by State,” accessed July 4, 2012, www.NationalMortgageSettlement.com/states.

³⁷ “State Attorneys General, Feds Reach \$25 Billion Settlement.”

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ See Morgenson.

⁴¹ “MERS: iRegistration Flyer.”

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

MERS is trying to stay within the requirements of ordinances, as well as take advantage of easy access to information; however, this may be all MERS needs to do. If MERS keeps this limited role in RMBS, this serves as a complete a solution for future transactions. The duty will not likely extend to maintaining the homes in their vacancy. That is the job of the banks, investors, or whatever entity holds the promissory note and legal title at the time of foreclosure. Tracking property preservation contact information with each mortgage is at least a strong step towards preventing communities from falling into despair. Past instances, however, cannot be forgotten, and MERS may have acted in such a wide scope as to induce a fiduciary duty to vacated homes. These homes, often unsellable in disrepair, need to be tended to. Neither the note holders nor MERS should escape that responsibility.

Stemming the Tide

In other countries, if property laws allow the legal title to be separated from the promissory note (rights to the payments), MERS may be able to expand to that country, creating a possible global issue. England uses subprime mortgages and had its own economic meltdown similar to the United States in 2008. This indicates that the English system may lend itself just as well to allowing MERS to handle RMBS transactions. Ethical issues, including fiduciary duty, ought to be fixed domestically first, thereby stemming the tide for any future application of MERS. If community misfortune can be in any measure avoided by addressing the duties of MERS, the necessary steps should be taken. In an age that is engulfed more and more by technology each year, electronic registration of mortgages may be inevitable; however, the resulting problems of such a process are not.

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