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MERS? It May Have Swallowed Your Loan

By MICHAEL POWELL and GRETCHEN MORGENSON

FOR more than a decade, the American real estate market resembled an overstuffed novel, which is to say, it was an engrossing piece of fiction.

Mortgage brokers hip deep in profits handed out no-doc mortgages to people with fictional incomes. Wall Street shopped bundles of those loans to investors, no matter how unappetizing the details. And federal regulators gave sleepy nods.

That world largely collapsed under the weight of its improbabilities in 2008.

But a piece of that world survives on Library Street in Reston, Va., where an obscure business, the MERS Corporation, claims to hold title to roughly half of all the home mortgages in the nation — an astonishing 60 million loans.

Never heard of MERS? That's fine with the mortgage banking industry—as MERS is starting to overheat and sputter. If its many detractors are correct, this private corporation, with a full-time staff of fewer than 50 employees, could turn out to be a very public problem for the mortgage industry.

Judges, lawmakers, lawyers and housing experts are raising piercing questions about MERS, which stands for Mortgage Electronic Registration Systems, whose private mortgage registry has all but replaced the nation's public land ownership records. Most questions boil down to this:

How can MERS claim title to those mortgages, and foreclose on homeowners, when it has not invested a dollar in a single loan?

And, more fundamentally: Given the evidence that many banks have cut corners and made colossal foreclosure mistakes, does anyone know who owns what or owes what to whom anymore?

The answers have implications for all American homeowners, but particularly the millions

struggling to save their homes from foreclosure. How the MERS story plays out could deal another blow to an ailing real estate market, even as the spring buying season gets under way.

MERS has distanced itself from the dubious behavior of some of its members, and the company itself has not been accused of wrongdoing. But the legal challenges to MERS, its practices and its records are mounting.

The Arkansas Supreme Court ruled last year that MERS could no longer file foreclosure proceedings there, because it does not actually make or service any loans. Last month in Utah, a local judge made the no-less-striking decision to let a homeowner rip up his mortgage and walk away debt-free. MERS had claimed ownership of the mortgage, but the judge did not recognize its legal standing.

“The state court is attracted like a moth to the flame to the legal owner, and that isn’t MERS,” says Walter T. Keane, the Salt Lake City lawyer who represented the homeowner in that case.

And, on Long Island, a federal bankruptcy judge ruled in February that MERS could no longer act as an “agent” for the owners of mortgage notes. He acknowledged that his decision could erode the foundation of the mortgage business.

But this, Judge Robert E Grossman said, was not his fault.

“This court does not accept the argument that because MERS may be involved with 50 percent of all residential mortgages in the country,” he wrote, “that is reason enough for this court to turn a blind eye to the fact that this process does not comply with the law.”

With MERS under scrutiny, its chief executive, R. K. Arnold, who had been with the company since its founding in 1995, resigned earlier this year.

A BIRTH certificate, a marriage license, a death certificate: these public documents note many life milestones.

For generations of Americans, public mortgage documents, often logged in longhand down at the county records office, provided a clear indication of homeownership.

But by the 1990s, the centuries-old system of land records was showing its age. Many county clerk’s offices looked like something out of Dickens, with mortgage papers stacked high. Some clerks had fallen two years behind in recording mortgages.

For a mortgage banking industry in a hurry, this represented money lost. Most banks no longer hold onto mortgages until loans are paid off. Instead, they sell the loans to Wall Street, which bundles them into investments through a process known as securitization.

MERS, industry executives hoped, would pull record-keeping into the Internet age, even as it privatized it. Streamlining record-keeping, the banks argued, would make mortgages more affordable.

But for the mortgage industry, MERS was mostly about speed — and profits. MERS, founded 16 years ago by Fannie Mae, Freddie Mac and big banks like Bank of America and JPMorgan Chase, cut out the county clerks and became the owner of record, no matter how many times loans were transferred. MERS appears to sell loans to MERS ad infinitum.

This high-speed system made securitization easier and cheaper. But critics say the MERS system made it far more difficult for homeowners to contest foreclosures, as ownership was harder to ascertain.

MERS was flawed at conception, those critics say. The bankers who midwived its birth hired Covington & Burling, a prominent Washington law firm, to research their proposal. Covington produced a memo that offered assurances that MERS could operate legally nationwide. No one, however, conducted a state-by-state study of real estate laws.

“They didn’t do the deep homework,” said an official involved in those discussions who spoke on condition of anonymity because he has clients involved with MERS. “So as far as anyone can tell their real theory was: ‘If we can get everyone on board, no judge will want to upend something that is reasonable and sensible and would screw up 70 percent of loans.’”

County officials appealed to Congress, arguing that MERS was of dubious legality. But this was the 1990s, an era of deregulation, and the mortgage industry won.

“We lost our revenue stream, and Americans lost the ability to immediately know who owned a piece of property,” said Mark Monacelli, the St. Louis County recorder in Duluth, Minn.

And so MERS took off. Its board gave its senior vice president, William Hultman, the rather extraordinary power to deputize an unlimited number of “vice presidents” and “assistant secretaries” drawn from the ranks of the mortgage industry.

The “nomination” process was near instantaneous. A bank entered a name into MERS’s Web site,

and, in a blink, MERS produced a “certifying resolution,” signed by Mr. Hultman. The corporate seal was available to those deputies for \$25.

As personnel policies go, this was a touch loose. Precisely how loose became clear when a lawyer questioned Mr. Hultman in April 2010 in a lawsuit related to its foreclosure against an Atlantic City cab driver.

How many vice presidents and assistant secretaries have you appointed? the lawyer asked.

“I don’t know that number,” Mr. Hultman replied.

Approximately?

“I wouldn’t even be able to tell you, right now.”

In the thousands?

“Yes.”

Each of those deputies could file loan transfers and foreclosures in MERS’s name. The goal, as with almost everything about the mortgage business at that time, was speed. Speed meant money.

ALAN GRAYSON has seen MERS’s record-keeping up close. From 2009 until this year, he served as the United States representative for Florida’s Eighth Congressional District — in the Orlando area, which was ravaged by foreclosures. Thousands of constituents poured through his office, hoping to fend off foreclosures. Almost all had papers bearing the MERS name.

“In many foreclosures, the MERS paperwork was squirrely,” Mr. Grayson said. With no real legal authority, he says, Fannie and the banks eliminated the old system and replaced it with a privatized one that was unreliable.

A spokeswoman for MERS declined interview requests. In an e-mail, she noted that several state courts have ruled in MERS’s favor of late. She expressed confidence that MERS’s policies complied with state laws, even if MERS’s members occasionally strayed.

“At times, some MERS members have failed to follow those procedures and/or established state foreclosure rules,” the spokeswoman, Karmela Lejarde, wrote, “or to properly explain MERS and document MERS relationships in legal pleadings.”

Such cases, she said, “are outliers, reflecting case-specific problems in process, and did not

repudiate the MERS business model.”

MERS's legal troubles, however, aren't going away. In August, the Ohio secretary of state referred to federal prosecutors in Cleveland accusations that notaries deputized by MERS were signing hundreds of documents without any personal knowledge of them. The attorney general of Massachusetts is examining a complaint by a county registrar that MERS owes the state tens of millions of dollars in unpaid fees.

As far back as 2001, Ed Romaine, the clerk for Suffolk County, on eastern Long Island, refused to register mortgages in MERS's name, partly because of complaints that the company's records didn't square with public ones. The state Court of Appeals later ruled that he had overstepped his powers.

But Judith S. Kaye, the state's chief judge at the time, filed a partial dissent. She worried that MERS, by speeding up property transfers, was pouring oil on the subprime fires. The MERS system, she wrote, ill serves “innocent purchasers.”

“I was trying to say something didn't smell right, feel right or look right,” Ms. Kaye said in a recent interview.

Little about MERS was transparent. Asked as part of a lawsuit against MERS in September 2009 to produce minutes about the formation of the corporation, Mr. Arnold, the former C.E.O., testified that “writing was not one of the characteristics of our meetings.”

MERS officials say they conduct audits, but in testimony could not say how often or what these measured. In 2006, Mr. Arnold stated that original mortgage notes were held in a secure “custodial facility” with “stainless steel vaults.” MERS, he testified, could quickly produce every one of those files.

As for homeowners, Mr. Arnold said they could log on to the MERS system to identify their loan servicer, who, in turn, could identify the true owner of their mortgage note. “The servicer is really the best source for all that information,” Mr. Arnold said.

The reality turns out to be a lot messier. Federal bankruptcy courts and state courts have found that MERS and its member banks often confused and misrepresented who owned mortgage notes. In thousands of cases, they apparently lost or mistakenly destroyed loan documents.

The problems, at MERS and elsewhere, became so severe last fall that many banks temporarily

suspended foreclosures.

Some experts in corporate governance say the legal furor over MERS is overstated. Others describe it as a useful corporation nearly drowning in a flood tide of mortgage foreclosures. But not even the mortgage giant Fannie Mae, an investor in MERS, depends on it these days.

“We would never rely on it to find ownership,” says Janis Smith, a Fannie Mae spokeswoman, noting it has its own records.

Apparently with good reason. Alan M. White, a law professor at the Valparaiso University School of Law in Indiana, last year matched MERS’s ownership records against those in the public domain.

The results were not encouraging. “Fewer than 30 percent of the mortgages had an accurate record in MERS,” Mr. White says. “I kind of assumed that MERS at least kept an accurate list of current ownership. They don’t. MERS is going to make solving the foreclosure problem vastly more expensive.”

THE Sarmientos are one of thousands of American families who have tried to pierce the MERS veil.

Several years back, they bought a two-family home in the Greenpoint section of Brooklyn for \$723,000. They financed the purchase with two mortgages from Lend America, a subprime lender that is now defunct.

But when the recession blew in, Jose Sarmiento, a chef, saw his work hours get cut in half. He fell behind on his mortgages, and MERS later assigned the loans to U.S. Bank as a prelude to filing a foreclosure motion.

Then, with the help of a lawyer from South Brooklyn Legal Services, Mr. Sarmiento began turning over some stones. He found that MERS might have violated tax laws by waiting too long before transferring his mortgage. He also found that MERS could not prove that it had transferred both note and mortgage, as required by law.

One might argue that these are just legal nits. But Mr. Sarmiento, 59, shakes his head. He is trying to work out a payment plan through the federal government, but the roadblocks are many. “I’m tired; I’ve been fighting for two years already to save my house,” he says. “I feel like I never know who really owns this home.”

Officials at MERS appear to recognize that they are swimming in dangerous waters. Several federal agencies are investigating MERS, and, in response, the company recently sent a note laying out a raft of reforms. It advised members not to foreclose in MERS's name. It also told them to record mortgage transfers in county records, even if state law does not require it.

MERS will no longer accept unverified new officers. If members ignore these rules, MERS says, it will revoke memberships.

That hasn't stopped judges from asking questions of MERS. And few are doing so with more puckish vigor than Arthur M. Schack, a State Supreme Court judge in Brooklyn.

Judge Schack has twice rejected a foreclosure case brought by Countrywide Home Loans, now part of Bank of America. He had particular sport with Keri Selman, who in Countrywide's court filings claimed to hold three jobs: as a foreclosure specialist for Countrywide Home Loans, as a servicing agent for Bank of New York and as an assistant vice president of MERS. Ms. Selman, the judge said, is a "milliner's delight by virtue of the number of hats that she wears."

At heart, Judge Schack is scratching at the notion that MERS is a legal fiction. If MERS owned nothing, how could it bounce mortgages around for more than a decade? And how could it file millions of foreclosure motions?

These cases, Judge Schack wrote in February 2009, "force the court to determine if MERS, as nominee, acted with the utmost good faith and loyalty in the performance of its duties."

The answer, he strongly suggested, was no.