May 6, 2016

To: Stephanie Heller
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Federal Reserve Bank of New York
and
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NCLC and Connecticut Fair Housing Center Comments to draft National Mortgage Note Repository Act of 2016 (draft released March 11, 2016)

National Consumer Law Center on behalf of its low-income clients and the Connecticut Fair Housing Center submit these comments by focusing primarily on the new material that appears in this March 2016 draft. These comments should be treated as cumulative to those we have previously provided orally and in writing, including our written comments dated February 27, 2015 and August 31, 2015. The section numbers refer to those in the draft distributed with Stephanie Heller's email of March 11, 2016:

[alt B] Section 4 (Repository Operator). The licensing alternative described here would be a step in the wrong direction. The option appears to allow a private entity, such as MERS, to take over a key role in the Registry system while distancing itself from the accountability structures that apply to governmental agencies (e.g. the APA, FOIA, due process). MERS has shown itself to be incapable of managing an accurate and transparent data system.

We reiterate our strong opposition to FHFA as Regulator. FHFA and the GSEs have a proprietary interest in the loans and servicing agreements subject to the Registry's activity. FHFA has developed a business model that eschews transparency and rejects public oversight and control of its operations. The Bill's continued authorization for FHFA to designate rules as "minor" in order to avoid the APA (Section 5 & Section 6) and the new text allowing FHFA to make determinations about preemption of state laws (Section 21) heighten our concerns.

Section 8(c) and 8(d)(4). Submission of Mortgage Notes. Section 8(c) does not require that only original paper notes are acceptable for submission to the Registry, and does not prohibit the submission of photocopies of lost notes. This will have the effect of eliminating the borrower protective provisions of UCC § 3-309, which we oppose. The act should expressly prohibit the submission of any evidence of an instrument, the original of which has been lost.

We oppose the limitation of damages language in Section 8(d)(4) which limits damages claims to those of “direct economic loss.” We find it most troubling to see this Act creating wholesale eliminations of borrower protective provisions in the UCC and UETA and E-Sign, while so limiting damages claims when gateways violate their warranties under Section 8(a)(4). Further, there should be an express provision inserted in this subsection for borrowers to recover their attorney fees and costs when they succeed in asserting breach of warranty claims.

The Act does not limit submissions to the Registry solely to new instruments. Such a limit should be imposed. A tremendous level of loan originator and loan servicer misconduct with existing mortgage loans has been demonstrated repeatedly of the last 10 years. These legacy obligations should not be allowed into this registry where it will result in major diminution of the ability of borrowers to defend against the enforcement of these dubious obligations.

S**ection 8(c)(2) (Submission of Mortgage Notes – Data Requirements) and Section 17(b) (Post-Submission Information – Notice by Registrant).** The draft continues to omit an express requirement that a Registrant submit complete and accurate information as to the identity of the loan’s owner (i.e., full name of the trust, trustee, addresses) and identify the guarantor/insurer. The guarantor or insurer typically sets loss mitigation guidelines for the loan. The required submissions itemized in Section 8(c)(2) do not include documents or links to documents that define the servicer’s authority to act for the loan’s owner (e.g. PSA agreements). All of this information could easily be added to a database, directly or by a link.

Our concerns about the omission of this critical information from the database are heightened by the new language in Section 17(b). Section 17(b) incorporates notice requirements for transfer of servicing under RESPA (12 U.S.C. § 2605(b)(3)) and the notice of new creditor under the TILA (15 U.S.C. § 1641(g)). Neither the RESPA nor the TILA notice provide the needed information about loan ownership described above. Neither statutory notice tells the borrower who owns the loan and who ultimately determines which loss mitigation options apply. Servicers routinely do not comply with 15 U.S.C. § 1641(g). The use of the term “creditor” in the TILA section has led to confusion as to whether the term refers to the loan’s owner, the person entitled to enforce (PETE) the note under Article 3 of the UCC, a non-owner assignee, a beneficiary, or guarantor. If the intent of Section 17(b) is to require that registered borrowers receive notice only of transfers of the right to enforce the note (transfer of PETE status), the provision will confuse rather than help consumers.

Section 16(b) ((Records, Access Rights, and Data Security). It is not clear what it means that the borrower has access to certain Registry information when “the borrower submits a request for such information in a manner prescribed by the system.” (§16(b)(1)(A)). Borrowers should have instantaneous access to the Registry information for their loan, just like financial institutions. Borrowers should also receive notice of the content of changes to this information, not simply that changes occurred as per Section 17(a)(1). The system for borrower notices will not work unless the Registry sends the borrower notice when loan information is first submitted. The initial notice must explain to the borrower what the Registry is and how to access information on an ongoing basis. The lack of an initial notice undermines the new requirement that the System Operator send the borrower notice of changes in Registry information in Section 17(a). Without notice of the initial submission, the borrower will not know what the notice of post-submission information means or what to do about it.

Section 16(b)(2) (Access by third parties). This provision allows a registrant to instruct the repository operator that another person is authorized to access the information concerning a deposited mortgage note. The registrant’s instruction constitutes a warranty by the registrant to the borrower that the authorized person will keep the information confidential and will not use it for any marketing purpose. This warranty expires if such authorized person becomes the registrant. This new provision raises privacy red flags for borrowers who are given no opportunity to object to access to Registry information about their obligations. The business rationale for this privacy intrusion is not explained. Moreover, the warranty remedies for breach under this Act are quite limited. In the event that the third party becomes a registrant, it is unclear if the automatic expiration of the warranty eliminates any claims for breach by the third party prior to acquiring registrant status.

Section 21(a) (Preemption and Scope). The newly added text states that FHFA may make determinations regarding whether a state statute, regulation, order, or interpretation of law is inconsistent with the Registry Act. This text is unnecessary and represents a significant overreach for a federal agency with proprietary interests in the loans it regulates. The potential for abuse under this provision is great. *See e.g.* Cuomo v. Clearing House Ass'n, L.L.C., 557 U.S. 519 (2009). The combination of this provision and the Repository Operator's ability to exempt itself from the APA's notice and comment requirements (Section 6) leaves the important issues of preemption subject to initial determinations that carry questionable validity and will be weighted with agency self-interest.

Section 8(c)(3) (Conversion to Electronic Notes and Section) and 9(a) (Effect of Conversion) These sections terminate the paper note upon conversion to an electronic mortgage note even though there is no requirement in the Act that the original note be deposited. Moreover, section 9(a) permits the regulator to issue regulations allowing the reconversion of the electronic mortgage note to a paper mortgage note. Essentially, these provisions legalize and expand upon the current Fannie Mae and Freddie Mac practice of requiring borrowers to agree to a reconversion of an electronic note to a paper note in their uniform eNotes for the legal convenience of these GSEs. Under current law, this practice is highly questionable.[1] Section 9(a) undermines the regimes created by Congress in E-Sign and the Uniform Law Commission in UETA (adopted as state law by most states). These acts were drafted for the explicit purpose of creating a statutory regime for electronic notes that is separate and distinct from the legal framework governing paper notes. This Act obliterates these distinctions and the result is to expand the scope of this Act's preemption and to contract protections inherent in standing and real party in interest doctrines as well as rules of evidence.

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[1] Section 9(a) undermines the regimes created by Congress in E-Sign and the Uniform Law Commission in UETA (adopted as state law by most states). These acts were drafted for the explicit purpose of creating a statutory regime for electronic notes that is separate and distinct from the legal framework governing paper notes. The drafters of UETA note that paper notes are unique because the piece of paper itself embodies ("reifies") intangible rights and obligations. "The extreme difficulty of creating a unique electronic token which embodies the singular attributes of a paper negotiable document or instrument dictates that the rules relating to negotiable documents and instruments not be simply amended to allow the use of an electronic record for the requisite paper writing." UETA § 16 cmt. 1; UETA § 3(b)(2) (the act does not apply to a transaction to the extent it is governed by the UCC). The official comments to UETA expressly invalidate a conversion of a paper note to an electronic note to "assure that a transferable record can only be created at the time of issuance by the obligor." The comment concludes: "The possibility that a paper note might be converted to an electronic record and then intentionally destroyed, and the effect of such action, was not intended to be covered by Section 16." Like UETA, the UCC determines negotiability at the time of issuance by the obligor. U.C.C. §§ 3-105(a) (1990) (defining "issue" as the "first delivery of an instrument by the maker…,whether to a holder or non-holder, for the purpose of giving rights on the instrument to any person."), 3-106 cmt. 1 (discussing the rationale behind the unconditional promise to pay element of negotiability, that is, a holder "should not be required to examine another document to determine rights with respect to payment."). As a result, negotiability must appear in the four corners of the note. *See also* U.C.C. § 3-201 cmt. 1 (a person can become a holder when an instrument is issued to that person). In the scenario created in paragraph 11 of the uniform eNotes, the paper copy of an electronic note bears the same date as the electronic note yet it is not issued until some later date. The date of issuance of the paper note cannot relate back to the date of creation of the electronic record.
See National Consumer Law Center, Foreclosures and Mortgage and Mortgage Servicing § 7.2a.5 (5th ed. 2014), *updated at* www.nclc.org/library (online version only).

Section 9(a), in conjunction with Section 8(c), will eliminate any need for a party seeking to enforce what was an eNote to prove the six safe-harbor facts contained in UETA § 16(c). This will leave borrowers with no defense against efforts to enforce an electronic mortgage note that arose out of an eNote that did not meet those safe harbor requirements, and will impose upon borrowers the burden of suing gateways for damages for wrongful submission of such (defective) eNotes. We likewise oppose this fundamental change in the law regarding the provisions of UETA and E-Sign.

The design of this Registry has evolved to the point where Sections 8 and 9 allow the registry to accept, without scrutiny, submissions of virtually any quality of proof of mortgage obligations, and sanitizes those obligations into fully enforceable electronic mortgage notes. The Act virtually eliminates all borrower defenses to defective instruments and related documents, and shifts fully to borrowers the burdens of proving these defects in breach of warranty claims in lawsuits that they must initiate. For this reason, we oppose the entire concept of the present structure of this Act that allows the deposit of garbage and converts it into clean debt obligations.

Section 12(a)(1)(C) (Transfers of Security Interests). This new text appears to create a significant exclusion of important information from the system. It encourages continued obfuscation of the information borrowers need to know about loan ownership. Borrowers need to know who owns their loan so they can understand which loss mitigation guidelines apply. This provision drives a wedge between enforcement of the note (the lender's rights) and consideration of loss mitigation (the lender's obligations), strengthening the former and undermining the latter. Registrants are not required to submit loan ownership information under Section 8(c). Borrowers do not receive notice of changes in loan ownership under Section 17(b). Loan ownership information is systematically excluded throughout the text.

Section 18(a)(2) (Presentment and Evidence; Agency). In the revised text, a certified record of the Registry as to the identity of a registrant, authorized transferor, or gateway creates "irrebuttable proof" of the party's identity. The section goes on to say, "[t]he validity of the content of all other certified records of the repository system shall be determined under other law." It is not clear from this new text what is covered by the "irrebuttable proof" standard and what must be determined under other law. Perhaps the intent is that the certified record of the identity of the registrant is irrebuttable proof that the identified party is a PETE. If so, the 'irrebuttable proof" goes to the party's legal status, not just the fact of "identity." The "irrebuttable proof" finding authorized by this Section appears to go to the party's authority *vis a vis* a contractual document and property interests historically defined under state law. If all of these meanings are encompassed within the term "identity of such party" in Section 18(a)(2), the text should give fair warning that this is what it means. The current language does not give that fair warning.

The two sentences making up Section 18(a)(2) create further confusion if the first sentence refers to "irrebuttable proof" of PETE status while the second sentence means that issues of loan ownership and the validity of contracts and security interests are all determined by state law and non-Registry federal law.

Section 9(b)(1) (Legal Effect of Conversion). The text should state expressly that no entity achieves holder-in-due course status through participation in the Registry when that entity would not otherwise have holder-in-due course status under applicable state law.

Section 12 (Transfers and Security Interests). Subsection (b) either assumes that Article 9 of the UCC applies to mortgage notes originated electronically or attempts to extend the application of Article 9 to these transactions. Article 9 does apply to electronic chattel paper but not to electronic mortgage notes. Applying Article 9 to mortgage notes originated electronically is a giant leap from current state law and, in effect, amends Article 9 without the legislative approval of all fifty states and territories. If Section 12(b) applies only to mortgage notes originated in paper and converted upon deposit in the Registry, the Act should be clear on this point. In addition, the word “indication” should be removed from (b)(2) as this permits something less than a “description” of the electronic mortgage note. A “description” should include enough information to reasonably identify each specific electronic mortgage note that the security agreement (sale agreement) covers.

Section 21 (Preemption, Scope, and Defense to Foreclosure). We strongly support the inclusion of a defense to foreclosure provision to this section. The name of the Act belies its scope and purpose. It is not merely a registration system to provide transparency. Rather, the scope of the preemption of other laws is significant and has grown over the course of the drafting process. Borrower protections inherent in the standing and real party in interest doctrines and burdens of proof and evidentiary rules have been eliminated entirely or replaced with a feeble set of warranties that provide little or no adequate remedies for violations of this Act. We urge the inclusion of the following as new section 21(c) Defense to Foreclosure: “Failure to comply with this Act by the person seeking to enforce an electronic mortgage note or to judicially or non-judicially foreclose upon an electronic mortgage note, by any prior registrant, by a gateway, or by an authorized transferor is a defense enforcement or to foreclosure.

Former Section 401 (discussion draft of Oct. 9, 2014). This section required that the registrant notify the Registry of the filing of a judicial foreclosure or other litigation to enforce the deposited obligation and identify the court in which the matter is or will be pending. In prior comments, we have consistently advocated that this notice requirement be expanded to include notice of the initiation of any non-judicial foreclosure and notice of the termination of any judicial and non-judicial process to enforce the obligation. Instead, the drafters removed all mention of notice of enforcement proceeding to the Registry. We object to this silence in the current version.

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