

MEMORANDUM

To: Uniform Law Commission
From: Edwin Smith and Steven Harris
Re: Draft Amendments to Uniform Commercial Code Articles 1, 3, and 9
Date: May 30, 2017

Summary of the purpose and content of the Act.

The Federal Reserve Bank of New York (NY Fed), in conjunction with the other Federal Reserve banks, has prepared draft federal legislation that would establish a repository for residential mortgage notes. The primary purposes of the repository are to clarify who is entitled to enforce the mortgage note, to provide an easy way for a mortgagor to determine the identity of the person who is entitled to receive payment of the mortgage debt, and to eliminate the transactional costs and burdens of lenders, securitizers and servicers in storing, maintaining, and transferring large volumes of paper notes.

The draft federal legislation, currently titled the National Mortgage Note Repository Act of 2017 (the *Repository Act*), would allow for both tangible and intangible notes (referred to as *mortgage notes*) to be submitted to the repository, converted into *electronic mortgage notes*, and transferred both outright and for security on the records of the repository system.

The current (January 27, 2017) draft of the Repository Act contemplates that submission and conversion would not adversely affect the rights of the parties to the mortgage note. Rights with respect to a submitted mortgage note would carry forward in the related electronic mortgage note, and the obligations of parties to a submitted mortgage note would become obligations on the related electronic mortgage note.

The Repository Act also contemplates that electronic mortgage notes would be transferable under legal rules that track those of Uniform Commercial Code Article 3. In addition, it contemplates that electronic mortgage notes would be treated like written notes under UCC Article 9. Inasmuch as UCC Article 3 does not apply to electronic notes and Article 9's treatment of electronic notes differs substantially from its treatment of tangible notes, new legal rules would be needed to accomplish these results. The amendments to these articles, together with amendments to UCC Article 1, would provide those new legal rules.

Coordinating the federal Repository Act with the UCC

The UCC amendments presented at the Annual Meeting have been drafted under the assumption that they would apply as enacted to electronic mortgage notes secured by real property located in a jurisdiction that has substantially enacted amended UCC Articles 3, 8, and 9 and the related definitions in Article 1, and that the federal Repository Act would contain

substantially identical commercial law rules applicable to electronic mortgage notes secured by residential real property located in jurisdictions that have not enacted the amended UCC articles.

Recently, however, the NY Fed has provisionally expressed comfort with a different approach for jurisdictions that do not substantially enact amended UCC Articles 3, 8, and 9 and the related definitions in Article 1. Under this approach, the UCC-related provisions would drop out of the federal act in the summer of 2018, when the UCC amendments are promulgated by the ALI and the ULC, and the UCC issues would be governed by the law of the relevant state as if it had enacted amended the Official Text of UCC Articles 3, 8 and 9 (and related definitions in Article 1). (As under the current approach, the UCC amendments would apply as enacted to electronic mortgage notes secured by real property located in a jurisdiction that does substantially enact amended UCC Articles 3, 8, and 9 and the related definitions in Article 1.)

The Drafting Committee has yet to discuss this approach, which is likely to require some adjustments to the amendments. The new approach is, of course, also subject to further review within the Federal Reserve System, and to Congressional action on the federal act that would require an accelerated timetable.

For the time being, the Repository Act will retain the UCC-related provisions in brackets, so that they can be used when considering the act within the Federal Reserve System and explaining the act to Congress.

Major issues for the Drafting Committee and Commissioners

The Drafting Committee has spent a fair amount of time considering the substance of the rules that would govern rights with respect to electronic mortgage notes and related mortgage notes. Attorneys for the NY Fed have been very receptive to suggestions from the Drafting Committee concerning both the substance and formulation of the new rules, with the view that the Repository Act and amended UCC should always yield the same results. No significant disagreement has arisen over the substantive provisions.

The overriding substantive issue is this:

- Does the draft achieve the right balance in protecting the interests of parties liable on the electronic mortgage notes and permitting holders and secured parties the ability to enforce electronic mortgage notes?

As regards the relationship between the UCC and the Repository Act:

- Is the allocation of rules between those in the UCC and those in the Repository Act appropriate?
- Which approach—retention of UCC-related rules in the Repository Act or federal adoption of the Official Text as the law governing UCC-related issues—will practitioners find more comprehensible and easier to use?