

MEMORANDUM

To: Uniform Law Commission
From: Edwin Smith and Steven Harris
Re: Proposed Amendments to Uniform Commercial Code Articles 1, 3, 8 and 9 for electronic residential mortgage notes
Date: May 29, 2018

This Memorandum provides (a) a brief summary of the Repository Act described below for residential mortgage notes, (b) an explanation as to why amendments to the Uniform Commercial Code (the *UCC*) are needed to give effect to the provisions of the Repository Act, (c) a summary of the choice-of-law rules in the Repository Act designed to facilitate the creation of national, uniform rules for the residential mortgage notes submitted to the repository while at the same time deferring to the state uniform law enactment process for enacting the UCC amendments, and (d) a statement of issues that the Commissioners may wish to consider at the Uniform Law Commission's 2018 annual meeting.

Summary of the Repository Act.

The Federal Reserve Bank of New York (the *NY Fed*) 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 a 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 2018 (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 design of the repository and its operation are intended to produce legal results substantially the same as would occur in wholly paper transactions for borrowers, lenders, and transferees of residential mortgage notes but at substantially lower costs and risk of error. Specifically, the drafters of the Repository Act contemplate that submission of a mortgage note to the repository and conversion of the mortgage note to an electronic mortgage note would not adversely affect the rights of the parties (borrowers, lenders, and transferees) to the mortgage note. Rights with respect to a submitted mortgage note would substantially 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 notes.

Amendments to the UCC

Inasmuch as UCC Article 3 does not apply to electronic notes and UCC Article 9's treatment of electronic payment rights differs substantially from its treatment of paper notes, new legal rules are needed to accomplish these results. Rather than creating a new legal system for electronic mortgage notes (modelled on UCC rules for paper notes) in the Repository Act, it was quickly concluded that it would be preferable to amend the UCC to provide the appropriate rules to bring about results for electronic mortgage notes that parallel the current treatment of paper notes. The proposed amendments to the UCC would provide those new legal rules.

The Drafting Committee worked in a collaborative manner, and no significant disagreement has arisen over the substantive provisions. In addition, the NY Fed and the Drafting Committee have reciprocally coordinated their drafting of the Repository Act and the UCC amendments. 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.

Choice of Law

Because the home-mortgage-note market is a national market, it is critical that the same rules for electronic mortgage notes apply throughout the country. It is, of course, possible that not all states will adopt the UCC amendments by the time that the repository system created by the Repository Act goes into effect. Section 20 of the Repository Act addresses this possibility by providing that to the extent a commercial-law issue would be governed by the law of a state:

- If that state's law includes provisions that are substantively identical to the proposed UCC amendments, the UCC of that state would apply as enacted to the commercial law matter.
- If that state's law does not include provisions that are substantively identical to the proposed UCC amendments, the law of that state would govern the commercial-law matter as if that state had enacted the UCC amendments. However, if that state's enactment of Article 3 of the UCC is based on a pre-1990 Official Text of the UCC, that state's law would govern the commercial-law matter as if that state had enacted the full Official Text of UCC Articles 1, 3, 8, and 9.

The Repository Act also is expected to allow the Federal Housing Finance Agency to issue binding orders determining whether the UCC in force in a particular state does or does not include provisions that are substantively identical to the UCC Amendments.

Major issues for the 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. 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?
- Does the choice-of-law rule in Section 20 of the Repository Act appropriately balance the need for national, uniform rules for electronic mortgage notes with the state uniform law enactment process for the UCC amendments?