Discussion of Major Changes in the December 19, 2016 Draft of the National Mortgage Repository Act of 2017 ("Act")

This document discusses the major changes made in the December 19, 2016 draft of the Act. It takes the March 11, 2016 draft as its baseline. The December draft is not final, although we do not anticipate more than one more round of changes in response to comments. We are requesting that you submit comments as soon as possible, but no later than April 1.

This document will discuss few drafting changes that convey no changes to meaning or policy. To pick an example, we altered "transfer" to "registered transfer." This was done solely for the sake of clarity, and is easy to pick up in the redline that accompanies the December draft. Some changes were substantive, but are highly technical and likely of interest to only a few. We shall not discuss these, either. For example, we truncated the scope of Chapter 97, on mixed-ownership Government corporations.

Section 3: the definitions of "record" and "transferable record" now contain a carve-out for any records that are recordings of oral communications. Although not necessary, for clarity the definition of "mortgage" now explicitly contains deeds of trust. We are hoping that by calling out the Act's application to deeds to trust those reviewing the Act will focus on any unique issues that may arise as a result of the deed of trust structure.

Section 4: There were no significant changes to the chartered option. The comments received on the March draft reveal that stakeholders remain divided as to whether the repository operator should be a government entity or a private sector entity. For this reason, both options remain in the Act for consideration by Congress.

Section 5(a) has a few new features. Paragraph (4) was added to address conflicting views by stakeholders with respect to bracketed language that had been in section 10(c) as to whether the repository system should be used to store records beyond those identified in sections 8 and 10, for example the entire servicing file. The drafters believe that providing this power to the regulator is the best way to address the diversity of views. We note that paragraph (4) may also be read to permit the regulator to authorize commercial mortgage notes for submission at some future date, but new Section 9(a)(2) will make this challenging for the regulator.

Section 6 dropped the "minor proposed system rules" based on unanimous feedback.

Section 7 changes were minor. However, a few things became increasingly clear in our minds. The function of the gateways while important is very limited. They ensure the authority of the person submitting records, data, and instructions to the repository operator and the integrity of those submissions. They do this through both their operations and warranties. Gateways must be used by registrants and authorized transferors.

Section 8(a) clarifies that a gateway does not become the submitter by virtue of being a gateway.

Section 8(c)(2) was revised to try to better balance the interests of borrowers and the likely practices of holders of mortgage notes. Specifically, we anticipate that a person may submit in the name of "agent" or other representative who becomes the registrant. To ensure that the repository

system accurately reflects the roles and interests of the parties, the Act requires that the capacity of the submitter and the person with the beneficial interest be disclosed (e.g., trustee of ABC Trust, servicer on behalf of ABC lender, etc.).

Section 8(c)(4) was revised. As previously drafted it implied that it was possible that a "bad" mortgage note through the submission process could become a valid and enforceable note. This was never the intent, but on reflection the drafters understood how it could be read this way and as a result the provision has been revised. In addition to this revision in Section 8, Sections 9 and 18 have been revised to provide additional clarity about the effect (or the lack of effect) of the conversion process.

Section 8(d): We added two warranties: that the note is a mortgage note and that the transmission is an accurate representation of the data. We did not further alter the warranties as the feedback that we received suggested that the draft may well be the right balance between those that would prefer no warranties and those that would prefer greater warranties.

Section 9 contains a number of significant changes. Section 9(a)(1) was revised to make it express that conversion does not affect the right of a borrower to assert a defense to the enforcement of a mortgage note.

Section 9(a)(2) (along with the clarification to Section 8(c)(4) and Section 18) resolves a problem that could occur: submission of records that do not qualify as a mortgage note. The addition of Section 9(a)(2) is intended to provide confidence to borrowers and others that the submission of "junk" into the system does not result in an enforceable mortgage note, and that the provisions of the Act do not apply. At the same time, the drafters were mindful that something could be submitted that evidences an enforceable obligation (though not a mortgage note as defined in the Act). We therefore left it to the courts to determine how to treat the records of the repository system with respect to these things (see section 18).

Section 9(b)(1)(B)(ii) reflects a discussion with the UCC 1-3-9 drafting committee. As the statute is drafted, a non-negotiable instrument is legally identical to a negotiable instrument, except there can be no holder in due course. The drafting committee wanted to mull whether other exceptions are wise.

Section 9(c) is completely new. In spirit, it follows the *Restatement (Second) of Torts* § 242 (1965). In effect, it is an attempt to deal with novel aspects of the law of intangible transferrable property rights. It states that the statutory *in rem* remedy (Section 20) is the exclusive relief from the repository operator, and the law of bailments does not apply to electronic mortgage notes. We believe limiting the applicability of the law of bailments will not affect practice, but it could affect documentation for warehouse lenders and we would be interested in further feedback. The new Section 9(c) does not abolish property torts, but eliminates any physical concepts of such torts, and concentrates on the policy behind them. It excludes repository operators and gateways from this tort liability. A delict by a gateway is a breach of contract, not a tort. A delict by a repository operator may be a tort, but is captured by Section 19.

Section 10(b) is new. Agreements that require borrowers to indemnify or otherwise pay registrants with respect to fines imposed on the registrant are unenforceable, and result in attorney's fees and statutory damages if the registrant seeks to enforce them.

Section 12(a)(1) is new drafting, but merely says explicitly what was implicit in the statute.

Section 13 contains two significant changes. The December draft makes clear that authorized transferor status persists when the authorized transferor transfers the EMN to a person not itself, unless the authorized transferor disclaims its status. This simplifies the task of an owner who retains authorized transferor status, while granting registrant status to its servicer. In contrast, if the registrant transfers the EMN, the status of authorized transferor ends. To protect an authorized transferor from losing its status under these circumstances, the authorized transfer can require the registrant to waive its right to transfer the EMN.

This draft expands the prior draft and allows for the registrant to waive not only its right to transfer an EMN but also its right to enforce an EMN for so long as there is an authorized transferor. It also provides a special rule for authorized transferors whose registrant waives its right to transfer the EMN. Such authorized transferors are deemed in possession of the EMN for purposes of Article 9 of the UCC. They still do not have the rights to enforce or foreclose, but do not have the duties of a registrant, either. We are especially interested in comment on this section. Could it be abused, especially by persons who wanted all the effective rights of a registrant without any of the responsibilities?

Section 16 has added some additional borrower protections and clarified rights for title companies.

Section 17 requires the repository operator provide notice to a borrower at the time that its mortgage note is converted and also provides requirements on the form of the notice to borrowers.

Section 18(a) clarifies the evidentiary treatment of repository system records in two ways. First, it limits the irrebuttable presumption to only registrant status. Second, it clarifies the evidentiary treatment of records that are not or are not associated with an EMN. The special evidentiary provisions of Section 18(a)(1) do not apply to such records, and the court is free to treat them as it will.

Section 18(b) imports a concept in banking law: that a gateway may refuse to deal with the agent of a customer, even if it is satisfied as to the agent's authority.

Section 19(a), which deals with multiple submissions, was revised to move away from a first in time approach to one that relies on resolution either by the affected parties or by a court.

Section 19(b) makes error correction by the repository operator mandatory, but is predicated on reasonable belief. It also establishes the rule where two innocent parties are harmed by the repository operator error – giving one of the parties registrant status and one monetary damages from the repository.

Section 20 was clarified. Section 20 is intended to address the scenario where a person other than the registrant claims an interest in an EMN. The section makes clear that the repository operator may ignore such claim unless and until a court orders otherwise.

Section 21 clarified that the Act does not affect consumer protection laws so long as such laws do not interfere with the purpose and intent of the Act. We also removed the list of federal laws that are not affected by the Act as it was unnecessary.

Several things that we did *not* change are noteworthy.

- Purposes (Section 2(b)). Some commenters wanted an open-ended statement of purpose. The list of purposes remains exclusive, since it is tied to the regulator's authority to issue regulations. (Subsections 5(a)(6) and (12))
- Controlled Records (Section 3). We have retained them for the time being, although some commenters do not see the value of them. We welcome more feedback as to whether this concept should be retained.
- RLN (Section 3). We received questions about RLNs. The drafters intend for the system rules and/or regulations to address the distribution of RLNs. One possibility is that each loan originator may obtain RLNs from the repository operator in advance of origination so that the RLNs are available to associate with the note and mortgage at the time of origination.
- System Rules and Exigencies (Section 6(d)). Several commenters asked whether we should use the APA standard for this provision on the belief that the APA standard would be more restrictive. The APA standard is actually more permissive, and so the drafters retained the March wording.
- Gateways (Section 7). A number of commenters were opposed to the notion of gateways, viewing them as unnecessary and expensive. We still view them as the only practical way to ensure the integrity of the repository system.
- Transfer and Equitable Subrogation (Section 12). Comment was provided on equitable subrogation. We have not made changes because we need additional guidance as to the concern and welcome drafting suggestions.

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