

# FEDERAL RESERVE BANK *of* NEW YORK

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**STEPHANIE HELLER**

DEPUTY GENERAL COUNSEL AND  
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March 6, 2013

William R. Breetz, Jr.  
Chairman  
Uniform Law Commission  
University of Connecticut School of Law  
Knight Hall Room 202  
35 Elizabeth Street  
Hartford, CT 06105

Dear Mr. Breetz:

During the February meeting of the Drafting Committee on the Residential Real Estate Mortgage Foreclosure Process and Protections Act, the Drafting Committee expressed an interest in considering further how the proposed Act could anticipate a national mortgage note and mortgage registry and transfer system. As noted in Tom Baxter's October 2012 letter to the Drafting Committee, we believe that this is an opportune time to contemplate a legal infrastructure that supports a movement away from paper mortgage notes and mortgages while ensuring reliable information exists on which to determine rights and obligations, that allows for the transfer of rights in a manner that better supports the originate-to-distribute business model and securitization, and that is oriented to protect the interests of all who are interested in mortgage finance, including borrowers. A national mortgage note and mortgage registry and transfer system could advance these goals.

Given the current state of the mortgage market, the design of such a system must be able to accommodate negotiable mortgage notes, non-negotiable mortgage notes originated in paper form, and transferable records (electronic notes). Ideally, in my view, the national registry and transfer system would image or otherwise capture in electronic form all of the information contained in the mortgage note and mortgage at the time that they are deposited into the system. After performing robust integrity checks on the data, the national registry would destroy the paper so that the electronic note was the only continuing obligation.<sup>1</sup> From that point forward, the appropriate book entries in the national registry and transfer system would effect the transfer of "ownership" of the note along with the corresponding legal right to enforce the mortgage.

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<sup>1</sup> Both the design and the implementing legislation would have to address the integrity of the data and the allocation of liability if the integrity of the data is later questioned.

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In order to achieve this vision of a national registry and transfer system, there will likely need to be Federal implementing legislation that, to some degree, preempts state law. By drafting the proposed Act with a national registry and transfer system in mind, the need for such Federal preemption could be minimized. Therefore, I turn now to the question of how the proposed Act could perhaps better support the development of a national mortgage note and mortgage registry and transfer system.

### Sections 401/403

Both alternatives in the February draft adopt the Uniform Commercial Code (“UCC”) Article 3 rules for negotiable instruments and require that the entity enforcing the instrument either have possession of the instrument or comply with the rules concerning lost or destroyed instruments.

As envisioned above, when an instrument is accepted into the national registry and transfer system, it would be destroyed. Once destroyed, it would be impossible for anyone to have possession of the paper instrument. Therefore, under the current draft, the only way in which a person could enforce such a note would be to satisfy the rules on lost or destroyed instruments. In some states (and under one version of section 403 in the draft Act), only the person who had possession of the note at the time it was destroyed would be entitled to enforce. This would suggest that once the instrument was submitted to the national registry and transfer system and destroyed, at best the only party that could enforce the note would be the lender that submitted the note to the system, and even that would require that the law (or a court) treat possession by the system as possession by the lender. The proposed rule would make it impossible for the system to then transfer rights to the note and mortgage, because transferees would not be able to satisfy the rules for lost or destroyed instruments.

Even if the draft Act adopted the version of UCC Article 3 that allows a person to enforce an instrument when such person was not in possession at the time the instrument was destroyed, I would suggest that the Act has not sufficiently considered the role of a national registry and transfer system in Sections 401 and 403. With the national registry and transfer system in place, for those loans deposited with the system there would be no need for a lost note affidavit or for the related protections. Instead all that would be required is a “certification” from the system as to who the lender is at the time of foreclosure or access to the system to make this determination. The records of the national registry and transfer system would have the force of law and would be the sole means of identifying who has the right to enforce the note and the mortgage.

To accommodate such a national system, a subsection might be added to Section 401 to state that foreclosure could also be accomplished by the person who is entitled to enforce the obligation as shown on the records of a federally-established registry of mortgage loans. In addition, Section 403 might be amended to provide that if an instrument secured by a mortgage is lost or destroyed after the mortgage loan to which it pertains is registered on the records of a federally-established registry of mortgage loans, the loss or destruction of the instrument has no effect on its enforceability or the foreclosure of the mortgage securing it.

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Of course there remains the possibility of duplicate “original” instruments and the sale of both “originals” to different parties, only one of which deposits the instrument into the national registry and transfer system. Either the proposed Act or the enabling legislation for the national system will need to allocate that risk between the system, the depositor of the loan into the system, and the party that holds the instrument.

### **Section 402**

An important underpinning of the national registry and transfer system is that the person with rights to enforce the note is and must be the same as the person with rights to enforce the mortgage. The legal rights of such a person do not change based on whether the enforcement action is on the note or with respect to the collateral. We therefore strongly support Section 402(a) which we interpret to be further codification of the concept that the mortgage follows the note. The rest of section 402, which we interpret to be about assignments of the mortgage and not the note, may be in tension with (a) to the extent that it suggests that the assignment of the mortgage is the operative act for obtaining foreclosure rights. The case law is sharply divided as to whether the right to enforce a nonnegotiable note can be transferred by an assignment of a mortgage. For a negotiable note, of course, a mortgage assignment has no such effect under UCC Article 3.

Ignoring for purposes of this letter whether there is any current obligation to record a mortgage, I would also suggest, that in the context of a national registry and transfer system, there is no need for recording transfers of the mortgage (which in all instances would occur as a legal matter based on the movements on the books of the system and not as a result of a formal assignment). As envisioned, the national system would be accessible to the borrower and enable the borrower to identify the current lender whenever the borrower had a need. To be clear, the national registry would not be used to determine the priorities among creditors and thus the originator of the loan would still have the same incentives as it has today to record the mortgage in the local land records. But the records of the recording office would not be relevant in a foreclosure action relating to a note deposited in the national registry and transfer system except where there was a question about the priority of the mortgage vis á vis other creditors.

To mesh with these concepts, Section 402 might be amended to state that a transfer of the right to enforce a mortgage as shown on the records of a federally-established registry of mortgage loans would be effective to transfer both the entitlement to enforce the obligation and to foreclose the mortgage.

I believe the above three sections of the February draft of the Act are the critical intersections with the national mortgage note and mortgage registry and transfer system project as currently envisioned. The holder in due course discussion also has relevance for the system and we will be following that discussion closely as it continues to develop. Two other areas of state law that I have identified as needing additional consideration are UCC Article 9 (the national registry will need to preserve the rights of secured parties as we move from paper to electronics) and state electronic signature acts.

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In closing, I hope this letter responds to the Drafting Committee's request, and I look forward to discussing this further with the Drafting Committee and other interested stakeholders.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Steph Heller', written in a cursive style.

Stephanie Heller  
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