The Mortgage Crisis, MERS, and Chapter 13

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The Mortgage Crisis was created by Mortgage Lenders, Banks, and Financial Institutions through the use of subprime lending and mortgage-backed securities. This article explores this crisis within the context of bankruptcy by examining subprime lending, mortgage securitization, MERS, and the situations within the U.S. Bankruptcy courts and Trustees have dealt with the fallout of the mortgage crisis first hand.

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I. The Mortgage Crisis

The mortgage crisis and the national U.S. economic crisis as a whole have been devastating to the continued prosperity, growth, and functionality of the economy at large in the United States. The main culprit in the bursting of the housing bubble was a combination of sub-prime lending practices and private mortgage-backed asset securities from banks and financial institutions. "Sub-prime" lending and mortgages are somewhat difficult to define in a straightforward manner[i]. The difficulty lies in the fact that, unlike prime mortgages, subprime mortgages are not all created equally. *Id.* As Sengupta & Emmons state, a simpler way to define exactly what is meant by "subprime" lending practices "might be to define a prime mortgage and then classify other non-prime mortgages as 'subprime' or 'near-prime.'" *Id.* at ¶ 5. A publication produced by the Board of Governors of the Federal Reserve System took this approach, and set out below is the table outline of their definitional construct for what constitutes subprime status:

Summary of Conventional Mortgage Market Segment Definitions

	Loan-to-value ratio		
Credit score	<80 Percent	80-90 Percent	>90 Percent
660 or higher	**Prime**	*Near-prime*	Subprime
581 to 659	*Near-prime*	*Near-prime*	Subprime
580 or lower	Subprime	Subprime	Subprime

SOURCE: Hancock, Diana; Lehnert, Andreas; Passmore, Wayne and Sherlund, Shane M. "An Analysis of the Potential Competitive Impacts of Basel II Capital Standards on U.S. Mortgage Rates and Mortgage Securitization." Basel II White Paper No. 4, Board of Governors of the Federal Reserve System, 2005. [ii]

A credit score is typically affected in a negative way by late or missed payments, using more than 80% of your total amount of available credit, filing bankruptcy, liens or foreclosures on property, periods of unemployment, and too many requests for new lines of credit. Many people with this sort of history are found as the typical debtor in bankruptcy. The loan-to-value ratio is simply the amount of the loan a mortgagor is planning to take out on the home in relation to the value of the home. For example, if a borrower wants to buy a home with a value of $100,000 but is only planning to spend $5,000 on the down payment, then his loan-to-value ratio would be 95% ($95,000 loan/$100,000 value). This does not even compute the typical costs and expenses of loan origination, as the majority of mortgage loans "roll" the costs of origination, appraisal, title search and insurance, and many other costs incidental to acquiring a mortgage loan into the loan total. This common practice would then boost the hypothetical above to somewhere closer to 97% or 98%. As one can imagine, there is a certain section of the U.S. populace that fits within the category of those whom would have a high to very high loan-to-value ratio by consequence of either not saving enough to pay a substantial down payment on their future home or irresponsibly acquiring a home with a value well beyond their means, which for the past several years has more than likely endured the hostile realities of a §341 meeting.

Mortgaged-backed securitization[iii] is the process in which many mortgage notes are purchased from banks and other lenders and assigned to a trust. These notes are "packaged" or "pooled" into a collection in this trust. This trust then issues certificates to investors. While this is a very oversimplified version[iv] of how mortgaged-backed securitization occurs, the basic gist of these agreements is the same across the board. The securities issued by the trust are usually divided into "tranches" to concentrate high-risk, low-risk, and medium-risk securities, and to divide the expected return into levels which will determine investment buy-in value. There are different varieties of mortgage backed securities, generally categorized by the nature of the collateral secured by the mortgage loans, such as Residential Mortgage-Backed Securities or Commercial Mortgage-Backed Securities.

II. Time is Money, and Speed is the name of the Game

For much of its existence, MERS went unnoticed and unimpeded on to accomplish its business objective in relative obscurity. So what is its purpose? According to MERS's website:

> MERS was created by the mortgage banking industry to streamline the mortgage process by using electronic commerce to eliminate paper. Our mission is to register every mortgage loan in the United States on the MERS System. Beneficiaries of MERS include mortgage originators, servicers, warehouse lenders, wholesale lenders, retail lenders, document custodians, settlement agents, title companies, insurers, investors, county recorders and consumers. MERS acts as nominee in the county land records for the lender and servicer. Any loan registered on the MERS System is inoculated against future assignments because MERS remains the mortgagee no matter how many times servicing is traded. MERS as original mortgagee (MOM) is approved by Fannie Mae, Freddie Mac, Ginnie Mae, FHA and VA, California and Utah Housing Finance Agencies, as well as all of the major Wall Street rating agencies[v].

Thus, the overall goal of MERS is clear—to streamline the recordation and assignment of mortgage notes to increase speed, eliminate paper, and facilitate the easier formation of mortgage-backed securities by supposedly eliminating traditional costs that are engrained within the property recording systems throughout every jurisdiction. MERS has member institutions that within the MERS system, and not through the traditional county recording offices, freely transfers to mortgages on its computer system. Thus, proof of the transfer many times will never show up in the county recording offices and will only be listed and recorded on MERS' computer system.

As a practical matter, MERS holds supposed title to approximately have of the mortgages in the U.S.—roughly sixty million mortgages. Powell & Morgenson, *MERS? It May Have Swallowed Your Loan*, N.Y.Times, March 5, 2011[vi]. MERS, though supposedly owning this many mortgages, only has a full-time staff of less than 50 employees. *Id*. MERS "owns" these mortgages by virtue of their position as "nominee" on all of these mortgage documents in the position traditionally occupied by the mortgagee-lender[vii]. The theory, as promulgated in MERS' above "mission statement," was to facilitate an easier way to transfer mortgage documents for the purpose of the creation of mortgage-backed securities. That, of course, is the "theory." MERS will, over the course of securitization, assign the note to several entities until it falls into the ownership of a holding trust or other trust that will use the notes as assets to back up the security certificates issued to investors. The note and mortgage will many times, if not every time, be split up physically between the designated trustee for the trust of the mortgage-backed securities and the designated servicer. Thus, by the time a default may have occurred on a mortgage obligation by a borrower, MERS could have hypothetically assigned the note many times away from the original lender from whom the borrower received his initial home loan. Likewise, the actual mortgage or deed of trust will be transferred or assigned several times as well for the purposes of creating mortgage-backed securities. As one article stated:

> [F]or the mortgage industry, MERS was mostly about speed—and profits. MERS, founding 16 years ago by Fannie Mae, Freddie Mac and big banks like Bank of America and JP Morgan Chase, cut out the county clerks and became the owner of record, no matter how many times loans were transferred. MERS appears to sell loans to MERS ad infinitum. This high-speed system made securitization easier and cheaper…[MERS's] theory was: "If we can get everyone on board, no judge will want to upend something that is reasonable and sensible and would screw up 70 percent of loans."[viii]

Powell & Morgensen, *supra*. So how did MERS create such amazing speed in its seemingly endless transfer of mortgage documents? Unfortunately, MERS's practices may not have been "on the up and up". MERS, as has come out through several journalistic investigations as well as court cases, employed what has commonly been referred to as "robo-signers," who sign thousands of documents and notarize them without knowing the actual contents of the mortgage documents. These practices have led to allegations of fraud, forged documents, documents that have been lost and then found miraculously during the course of foreclosure actions and adversary proceedings within bankruptcy cases. It is to this that we now turn our attention.

III. Debtors, Trustees, and Bankruptcy Judges take a closer look

MERS and those who allegedly direct its actions—Banks, Financial Institutions, etc.—have come under increased scrutiny for their paper work and documentation practices in the past several years within the context of bankruptcy proceedings. The main scenario is: (1) debtor files their petition, usually in lieu of an impending foreclosure, (2) MERS files either a motion for relief from the automatic stay under §362(b) or files a proof of claim, and (3) either debtor or trustee challenges the efficacy of either (a) MERS' or a Banking/Financial Institution standing to file the motion or proof of claim or (b) the evidence for the claim itself.

A. Uniform Commercial Code considerations

The basic tenet of mortgage law is "the Security follows the Obligation." In practical terms, this classic rule of mortgage law means that whoever owns the obligation (the promissory note) owns the right to the collateral (the mortgage or deed of trust for the home). Many of the issues MERS and the mortgage industry have encountered within bankruptcy court rooms have been related to this main axiom of mortgage law and through the laws about negotiable instruments contained with the Uniform Commercial Code (UCC). In particular, UCC §§ 2-203[ix], 3-301[x], and 3-309[xi], as well as other UCC provision, have been of special importance. These issues came to the forefront in *In re Kemp*, 2010 WL 4777625 (Bankr.D.N.J.) where MERS, Countrywide Home Loans, and the Bank of New York ("BONY") were all involved in a claim within a Chapter 13 case. In *Kemp*, a summation of the facts was provided as follows:

> [A]t the time of the filing of the proof of claim, the debtor's mortgage had been assigned to the Bank of New York, but that Countrywide did not transfer possession of the

> associated note to the Bank. Shortly before trial in this matter, the defendant executed an allonge to transfer the note to the Bank of New York; however, the allonge was not initially affixed to the original note, and possession of the note never actually changed. The Pooling and Servicing Agreement required an indorsement and transfer of the note to the Trustee, but this was not accomplished prior to the filing of the proof of claim. The defendant has now produced the original note and has apparently affixed the new allonge to it, but the original note and allonge still have not been transferred to the possession of the Bank of New York. Countrywide, the originator of the loan, filed the proof of claim on behalf of the Bank of New York as Trustee, claiming that it was the servicer for the loan. Pursuant to the PSA, Countrywide Servicing, and not Countrywide, Inc., was the master servicer for the transferred loans. At all relevant times, the original note appears to have been either in the possession of Countrywide or Countrywide Servicing.

Id. at *3. The issue before the *Kemp* court was "whether a challenge to the proof of claim filed on behalf of the Bank of New York, by its servicer Countrywide, can be sustained. Under 11 U.S.C. §502(b)(1), if an objection to a claim is made, the claim is disallowed "to the extent that…such claim is unenforceable against the debtor and the property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." The *Kemp* court ruled that the claim had to be disallowed for two reasons. First, Under New Jersey's UCC provisions, Bank of New York's lack of possession of the note was fatal to its enforcement. Second, the fact that the note was not properly indorsed to the new owner defeated enforceability of the note. The *Kemp* court concluded that because Bank of New York never was the "holder", "nonholder in possession", or "Non-holder not in possession" under the applicable provisions of the New Jersey UCC, they had no right to enforce the note, and the claim was disallowed under §502(b)(1).

In *Marks v. Braunstein*, 439 B.R. 248 (D.Mass. 2010), a similar situation occurred within the context of a Chapter 13 case which was converted to a Chapter 7 case. The assignee of the note on debtor's mortgage bought the mortgage at public auction from the Trustee and the deed was recorded. Subsequently, the assignee filed a proof of claim in debtor's bankrtupcy. Assignee then moved to "assert a lien and/or determine offset" seeking to apply a portion of the amount owed to him under the note toward his purchase of the residence at auction. *Id.* at 249. At the hearing, the assignee admitted he was "(1) not in possession of the note, (2) unaware where it was located, and (3) unaware of who was in possession of it." He further stated that he did not meet the statutory requirement for enforcement. *Id.* at 250. In reaching the conclusion that the assignee was "in a Catch-22 position[xii]", the district judge analyzed UCC §§ 3-301 and 3-309 to declare that "[a]lthough the Land Court recording is conclusive evidence of the assignment of the mortgage to [the assignee]…the mortgage merely provides security for the underlying obligation. It does not constitute evidence that [the assignee] ever possessed the note, which is clearly required by §3-309." *Id.* at 251.

In *In re Agard*, 2011 WL 499959 (Bankr.E.D.N.Y.)[xiii], important language was produced in a memorandum opinion on the status and powers of MERS in these situations. In *Agard*, the fundamental question was "whether MERS had the legal authority to assign a valid and enforceable interest in the subject mortgage." *Id.* at *1. The court examined the business model of MERS and its efficacy in New York law. The court stated:

> Specifically MERS's role in the ownership and transfer of real property notes and mortgages is at issue in dozens of cases before this Court…MERS has intervened in this proceeding arguing that the validity of MERS assignments directly affects its business model and will have a significant impact on the national mortgage industry…
>
> However, in order to have standing to seek relief from stay, Movant, which acts as the representative of U.S. Bank, must show that U.S. Bank holds both the Mortgage and the Note…Movant has produced no evidence, documentary or otherwise, that U.S. Bank is the rightful holder of the Note. Movant's reliance on the fact that U.S. Bank's noteholder status has not been challenged thus far does not alter or diminish the Movant's burden to show that it is the holder of the Note as well as the Mortgage…
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> Under New York law, Movant can prove that U.S. Bank is the holder of the Note by providing the Court with proof of a written assignment of the Note, or by demonstrating that U.S. Bank has physical possession of the Note endorsed over to it…Not only is the language vague and insufficient [within the assignment] to prove an intent to assign the Note, but MERS is not a party to the Note and the record is barren of any representation that MERS, the purported assignee, had any authority to take any action with respect to the Note. Therefore, the Court finds that the Assignment of Mortgage is not sufficient to establish an effective assignment of the Note…

> By MERS's own account, it took no part in the assignment of the Note in this case, but merely provided a database which allowed its members to electronically self-report transfers of the Note. MERS does not confirm that the Note was properly transferred or in fact whether anyone including agents of MERS had or have physical possession of the Note. What remains undisputed is that MERS did not have any rights with respect to the Note and other than as described above, MERS played no role in the transfer of the Note.
>
> Absent a showing of a valid assignment of the Note, Movant can demonstrate that U.S. Bank is the holder of the Note if it can show that U.S. Bank has physical possession of the Note endorsed to its name…However, there is nothing in the record to prove that the Note in this case was transferred according to the processes described above other than MERS's representation that its computer database reflects that the Note was transferred to U.S. Bank. The Court has no evidentiary basis to find that the Note was endorsed to U.S. Bank or that U.S. Bank has physical possession of the Note. Therefore, the Court finds that Movant has not satisfied its burden of showing that U.S. Bank, the party on whose behalf Movant seeks relief from stay, is the holder of the Note.

Agard, 2011 WL 499959 at *10-*12. MERS also tried to get by on an agency theory under its "nominee" status, but the court was not persuaded by this reasoning either stating, "[E]ven if MERS had assigned the Mortgage acting on behalf of the entity which held the Note at the time of the assignment, this court finds that MERS did not have authority, as 'nominee' or agent, to assign the Mortgage absent a showing that it was given specific written directions by its principal." *Id.* at *20. Nevertheless, it is important to note that this agency theory has been successful in at least one other jurisdiction. *See generally In re Martinez*, 2011 WL 489905 (Bankr.D.Kan.). In sum, the lesson to trustees and debtors attorneys is clear: when the debtor's mortgage is a part of the secondary mortgage market—in particular, a mortgage-backed security—it is incumbent on those involved to thoroughly and completely examine the documents and the proof of ownership of those documents. In doing so, the main secured claim of many debtors' estates may be disallowable, rendering a much more favorable administration of that debtor's estate either through liquidation, reorganization, or a Chapter 13 plan.

B. Possible Areas for the Future Consideration with MERS et al.

11 U.S.C. §502(a) provides that "a claim or interest…is deemed allowed, unless a party in interest…objects." A bankruptcy court will disallow a claim to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. §502(b)(1). The "applicable law" in this instance is of course state property laws in the state in which the bankruptcy court sits. In addition, 11 U.S.C. §510(c), in pertinent part, states:

> [A]fter notice and a hearing, the court may—
> (1) under the principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
> (2) order that any lien securing such a subordinated claim be transferred to the estate.

Under the doctrine of equitable subordination, a bankruptcy court may subordinate a particular claim if it finds that the creditor's claim, while not lacking a lawful basis nonetheless results from inequitable behavior on the part of that creditor. *In re Enron Corp.*, 379 B.R. 425 (S.D.N.Y. 2007) (citing *Musso v. Ostashko*, 468 F.3d 99, 109 (2nd Cir. 2006)); *see also In re First Alliance Mortgage Company*, 471 F.3d 977, 1006 (9th Cir. 2006). At the time of the enactment of §510(c), courts had uniformly adopted the three-pronged test set forth by the Fifth Circuit in *In re Mobile Steel Co.*, 563 F.2d 692 (5th Cir. 1977), for evaluating whether to equitably subordinate a claim: (1) the subordinated creditor must have engaged in "some type of inequitable conduct"; (2) the misconduct must have "resulting in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant"; and (3) equitable subordination of the claim must "not be inconsistent with the provisions of the Bankruptcy Act." *Mobile Steel*, 563 F.2d at 700. Inequitable conduct under the first prong is generally defined as either (1) fraud, illegality, or breach of fiduciary duties; (2) undercapitalization; or (3) the claimant's used of the debtor as a mere instrumentality or alter ego. *Enron Corp.*, 379 B.R. at 433. The second prong is met where the general creditors are less likely to collect their debts as a result of the alleged misconduct. *Id.* at 434. The third prong "has been read as a reminder to the bankruptcy court that although it is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable. *Id.* (citing *U.S. v. Noland*, 517 U.S. 535, 539 (1996)). The purpose of equitable subordination is to undo wrongdoing by an individual creditor in the interest of the other creditors. *In re Applied Theory Corp.*, 345 B.R. 56, 59 (S.D.N.Y. 2006) (citing *In re Lockwood*, 14, B.R. 374, 380-81 (Bankr.E.D.N.Y. 1981)). Many courts view equitable subordination as a drastic and unusual remedy. *In re Radnor Holding Corp.*, 353 B.R. 820, 840-42 (Bankr.D.Del. 2006). In addition, the "doctrine is remedial, not penal, and should applied only to the extent necessary to offset specific harm that creditors have suffered on account of the inequitable conduct." *In re SubMicron Sys. Corp.*, 291 B.R. 314, 327 (D.Del. 2003) (citing *Trone v. Smith*, 642 F.2d 1174, 1178 (9th Cir. 1981)).

Added to these provisions is an equitable power of the court that has not been explored very often by the courts—equitable disallowance. The term "equitable disallowance" is not found anywhere within the Bankruptcy Code, but the efficacy of such a power was squarely in front of the court in *Adelphia Recovery Trust v. Bank of America, N.A.*, 390 B.R. 64 (S.D.N.Y. 2008). In *Adelphia*, a Chapter 11 case, Adelphia asserted violation of the Bank Holding Company Act, 12 U.S.C. §1972, and sought to equitably subordinate and/or disallow the bank lenders' claims. The bankruptcy judge ruled that certain claims of the defendants were equitably disallowed, and on appeal defendants argued that such a power is not available because of its lack of inclusion within the language of §502(b), §510, or anywhere else in the Bankruptcy Code. After very thorough and exhaustive search of the legislative history of the current §510, the court disagreed with the defendants and stated that equitable disallowance is indeed available to bankruptcy courts as courts of equity, regardless of the language of the Code. In so ruling, the *Adelphia* court provided:

> Judge Gerber recognized that the Bankruptcy Code does not expressly provide for equitable disallowance of claims, but reasoned that 11 U.S.C. §§ 510(c) and 502, silent on the subject, do not prohibit it, and that a very specific statement in the Bankruptcy Code's legislative history—to the effect that Section 510(c) is intended to codify case law, including *Pepper v. Litton*, 308 U.S. 295 (1939), and does not preclude a bankruptcy court from completely disallowing a claim in appropriate circumstances…
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> The end result, Section 510 of the Bankruptcy Code as passed by Congress and signed by the President contains no provision for equitable disallowance. In the circumstances, and in the light of how the Act was finally put together as described in *Virtual Network* [902 F.2d 1246 (7th Cir. 1990)], the Court cannot give any weight to the omission of Section 510(c)(3) of S.2266 from the Bankruptcy Code, Congress could have decided to do away with equitable disallowance, or it could have thought specific reference to it was superfluous…[T]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications…
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> The Supreme Court has also pointed out "statements in the legislative history [of the Bankruptcy Code] that Congress intended that the term "principles of equitable subordination" [in 11 U.S.C. § 510(c)(1)] follow existing case law and leave to the courts development of this principle…*Pepper v. Litton*, fairly read, certainly endorses the practice (in appropriate circumstances) of the equitable disallowance of claims, not on the basis of any statutory language, but as within the equitable powers of a bankruptcy court. For reasons already described, the legislative history cited by the parties neither mandates nor prohibits equitable disallowance, but, on the other hand, nothing has been cited from the legislative history to suggest a Congressional intent to disavow *Pepper v. Litton* and eliminate equitable disallowance in any and all circumstances…For these reasons, the Court agrees with Judge Gerber's conclusion that "equitable disallowance is permissible under *Pepper*.

Adelphia, 390 B.R. at 74-76 (citations and internal quotations omitted). Thus, it would seem that while equitable disallowance does not expressly exist within the Bankruptcy Code, it is a power that at least one court has said exists for the bankruptcy court to utilize when the circumstances call for it.

As is well documented, MERS and the many banks, mortgage lenders/servicers, and financial institutions with which it does business have participated in actions within litigation that at the very least can be called unethical and at worst fraudulent[xiv]. These practices, in the author's opinion, open the door to utilize §502(b)(1), §510(c), and equitable disallowance of claims of these parties. As a hypothetical, suppose that MERS or the financial institutions for whom its works files a claim within a Chapter 13 bankruptcy case. It is a secured claim and the debtor wants to keep his/her home by way of his plan. The trustee or trustee's staff attorneys receive the proof of claim, and on the face of the documents, it appears to be a run-of-the-mill mortgage claim with the proper documentation. If there are questions as to the efficacy of the documentation at the outset, the trustee can of course object to the claim then and there, questioning the validity of whether the claimant is indeed the holder of the note or has the power to enforce. *Cf. In re Agard*, *supra*; *Marks v. Braunstein*, *supra*. Hypothetically, however, suppose much more time goes by for objection to a claim, and as a consequence the bankruptcy judge allows the claim. The author believes in this very specific situation, the legal analysis above might be amenable to such a situation. If the trustee or debtor can prove fraud on some sort of level by MERS or the financial institutions, then the claim could be subordinated to other claims in the case. In egregious instances of fraudulent conduct, the judge could order that the lien in that claim be transferred over to the estate. 11 U.S.C. §510(c)(2). In even more egregious cases, equitable disallowance of the claim altogether could be on the table. In addition, since property laws have a great variance across U.S. jurisdictions, a trustee or debtor needs to be very aware of that state's "applicable law". If the state laws give some sort of power to disallow claims or strip liens due to a creditors inequitable conduct, such power could be utilized by §502(b)(1). In many cases, since the mortgage is generally one of the most prevalent and largest claims to a debtor's estate, any ability to subordinate or eliminate these claims would be of great use to the debtor, other creditors to the estate, and the trustee.

Conclusion

This article is by no means is a total strategy to battle MERS and its affiliates, that much is certain. Already, many trustees and bankruptcy judges have taken a much closer look at mortgage documents and have started utilizing the powers given to them in the Bankruptcy Code to attack the validity of mortgage claims. The author's aim with this article is to examine the mortgage crisis, MERS, current litigation trends and strategies, and some prospects for debtors, trustees, and judges to attack the validity of secured mortgage claims within the context of bankruptcy cases. This is by no means an all-inclusive article, but one rather that the author hopes will be the "tip of the iceberg"—opening up discourse on to potential ways to attack suspect mortgage claims and the documents that represent them. Research has not rendered many instances where §510 or equitable disallowance have been discussed within the context of MERS, Financial Institutions, mortgage-backed securities, and possible fraudulent conduct by those creditors. This is not to say that such cases do not exist, but that there seems to be a relative dearth of precedent about this particular topic. As such, the author hopes that this article may open up new theoretical and practical pathways to the possible attack and disallowance of secured mortgage claims from MERS and financial institutions in bankruptcy cases.

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[i] *See Generally* Sengupta & Emmons, *What is Subprime Lending?*, Monetary Trends (June 2007), *available at* research.stlouisfed.org/publications/mt/20070601/cover.pdf

[ii] Hancock et al., *An Analysis of the Potential Competitive Impacts of Basel II Capital Standards on U.S. Mortgage Rates and Mortgage Securitization*, Basel II White Paper No. 4, Board of Governors of the Federal Reserve System, 2005.

[iii] The history of securitization is actually somewhat surprising, as it was initially a creation of the U.S. government and was indeed encouraged by the U.S. government to foster investment in the real estate market. In 1960, the U.S. government enacted the Real Estate Investment Trust Act of 1960 (Pub. L. 86-779, 26 U.S.C. §856 *et. seq.* (1960)) to allow the creation of Real Estate Investment Trusts (REIT's) to encourage real estate investment. *See* Fabbozi & Modigliani, *Mortgage and Mortgage-backed Securities Markets*, (Boston: Harvard Business School Press, 1992). In 1968, Ginnie Mae guaranteed the first mortgage pass-through security of an approved lender. *Id.* at 21. In 1971, Freddie Mac issued its first mortgage pass-through, called a "participation certificate," composed primarily of private mortgages. *Id*. In 1977, Bank of America issued the first private label pass-through security. *Id.* at 31. In 1981, Fannie Mae issued its first mortgage pass-through, called a "mortgage-backed security." *Id.* at 23. In 1983,

Freddie Mac issued the first collateralized mortgage obligation. *Id.* at 25. In 1984, the U.S. government passed the Secondary Mortgage Market Enhancement Act (Pub. L. 98-440, 15 U.S.C. §77r-1 (1984)) (SMMEA) to improve the marketability of such securities. *Id.* at 31. The Tax Reform Act of 1986 (Pub. L. 99-514, 100 Stat. 2085 (1986)) allowed the creation of tax-free Real Estate Mortgage Investment Conduit (REMIC) as a special purpose vehicle for the express purpose of issuing pass-through securities. *Id.* at 33-34. In response to the "savings and loan crisis" of the 1980's, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Pub. L. 101-73 (1989) (FIRREA) dramatically changed the savings and loan industry and its federal regulation, encouraging loan origination. *Id.* at 26. Finally, the Gramm-Leach-Bliley Act of 1999 (Pub. L. 106-102, 133 Stat. 1338 (1999)) (also referred to as the "Financial Services Modernization Act of 1999) had the effect of opening up the markets among banking companies, securities companies, and insurance companies. The direct effect of this Act was to repeal part of the Glass-Steagall Act of 1933, specifically the prohibition of any one institution from acting as any combination of an investment bank, a commercial bank, and an insurance company. As a result, commercial banks, investment banks, securities firms and insurance companies could consolidate under one business entity. This deregulation and subsequent merger of various institutions, coupled with pervasive subprime mortgage lending, arguably set the stage for the mortgage crisis which has deeply impacted the American economy to this day.

[iv] The author is currently working as a law clerk for an attorney with respect to litigation involving one of these Mortgage-Backed Securities transactions. In that particular transaction, there was a Delaware Statutory Trust (which would serve as pass-through entity for certificates and as an initial transferee of the mortgage notes), a New York common law Holding trust (which would serve, supposedly, as the custodian and holder of the mortgage documents and issue pass-through certificates), and a Cayman Trust (which would serve as the recipient of the pass-through certificate from the Holding Trust via the Delaware Trust transferring it and would issue the actual security certificates for each of the tranches to predetermined investors). The mortgage servicing rights were actually separated from the mortgages themselves and sold to the trustee for the Holding Trust, who then assigned those servicing rights to a self-chosen mortgage servicing company. This is just one example of the complexity of these transactions, and it typifies where the confusion that a trustee or bankruptcy judge would face when asking simple questions such as, "Who owns the note?" or "Can you prove ownership of this mortgage?".

[v] Found at: http://www.mersinc.org/about/index.aspx

[vi] Available at http://www.nytimes.com/2011/03/06/business/06mers.html

[vii] As my Bankruptcy Professor Henry Hildebrand once stated to me in one of our several conversations about MERS, "What on earth is a 'nominee'? I really don't have any real idea, and interestingly enough, neither does MERS." To be sure, Black's Law Dictionary, in pertinent part, defines a "nominee" as both "A person designated to act in the place of another, usually in a limited way," and also as "A party who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others."

[viii] As an example of this somewhat arrogant position held by MERS and the mortgage industry at large, Judge Boyko of the United States District Court for the Northern District of Ohio noted, in response to several banks and mortgage lenders proverbially "puffing their chests" at the ability of the court to adjudicate its claim, "Plaintiff's, 'Judge, you just don't understand how things work,' argument reveals a condescending mindset and quasi-monopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process…[T]he financial institutions or successors/assignees rush to foreclose, obtain a default judgment and then sit on the deed, avoiding responsibility for maintaining the property while reaping the financial benefits of interest running on the judgment. The financial institutions known the law charges the one with title (still the homeowner) with maintaining the property…However, unchallenged by underfinanced opponents, the institutions worry less about jurisdictional requirements and more about maximizing returns. Unlike the focus of financial institutions, the federal courts must act as gatekeepers,…The institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance. Finally put to the test, their weak legal arguments compel the Court to stop them at the gate." *In re Foreclosure Cases*, 2007 WL 3232430, at *3 (N.D.Ohio).

[ix] UCC §2-203 provides: "(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument. (b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument. (c)Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made. (d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this Article and has only the rights of a partial assignee.

[x] UCC §3-301 provides: "Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d) ["Payment or Acceptance by Mistake"]. A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

[xi] UCC §3-309 provides: (a) A person not in possession of an instrument is entitled to enforce the instrument if: (1) the person seeking to enforce the instrument: (A) was entitled to enforce the instrument when loss of possession occurred; or (B) has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when loss of possession occurred; (2) the loss of possession was not the result of a transfer by the person or a lawful seizure; and (3) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process. (b) A person seeking enforcement of an instrument under subsection (a) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 3-308 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

[xii] "[The assignee] is in a Catch-22 position. Either he possessed the Note and was not diligent in producing it or he was diligent in looking for it but did not possess it. Either way, he cannot succeed on a motion for reconsideration." *Marks v. Braunstein*, 439 B.R. at 253.

[xiii] It would be important to note that while the *Agard* court wrote a heavy-handed opinion on MERS' practice, ultimately the motion to life the stay was granted because a foreclosure had already occurred and application of either the *Rooker-Feldman* doctrine or *res judicata* could not attack the merits of the foreclosure sale.

[xiv] *See generally* Lynn E. Szymoniak, *Deutsche Bank, Securitization Fraud, and Foreclosure Fraud*, Fraud Digest (April 23, 2011) *available at* http://frauddigest.com/pdfs/DBSF.pdf; Lynn Szymoniak, *Mortgage Assignments, Mortgage Servicers and Securitized Trusts in Bankruptcy Cases*, Fraud Digest (January 9, 2011) *available at* http://frauddigest.com/pdfs/BankruptcyDecisionsOverview.pdf; Szymoniak, *Trusts Using Lending Processing Services Documents in Foreclosures*, Fraud Digest (Dec. 7 2010) *available at* http://frauddigest.com/trustlist.php; Szymoniak, *The Real Employers of the Signers of Mortgage Assignments to Trusts*, Fraud Digest (April 15, 2010); Powell & Morgensen, *supra*; For a great 60 minutes segment piece on Szymoniak and foreclosure fraud in general, see video at http://stopforeclosurefraud.com/2011/04/03/explosive-video-cbs-60-minutes-lynn-szymoniak-esq-lps-docx-fdic-sheila-bair-robo-signing-linda-green-tywanna-thomas-chris-pendley/ (video in middle of page).