Response to the Press Release and Report Issued
by the Office of the Assessor-Recorder of San Francisco
Relating to Foreclosure in California
Dated: March 22, 2012

Summary: The statistics in the press release and in the report overstate the non-compliance with California state law for the foreclosures files sampled. The primary reason for this is a misapplication of some of the basic concepts and legal principles underlying the lending process secured by real estate and the foreclosure laws. Moreover, there is a gross misunderstanding by the author about the purpose of the public recording system.

More importantly, the report does not point to any instance where the author produces evidence that a homeowner has actually been damaged by any foreclosure included in the sample. The report merely speculates about such kinds of damages that could arise.

Most of this paper will respond to the material found in Section 5 of the report, entitled Presentation of Findings. The commentary and conclusions in the rest of the report are not addressed here because their veracity is dependent on findings in Section 5, which (as will be described below) are not accurate. Portions of the report rely on information contained in unidentified proprietary databases and reviews preformed using proprietary rules-based auditing software. No support for the accuracy of any of this proprietary information is provided in the report, so reliance on any conclusions drawn from that information is suspect. The report also does not provide examples of the alleged violations, just a summary description of the conclusions, so a reader of the report is dependent on the author's understanding of the situation and is thus unable to judge the accuracy of the report for himself or herself.

Section 5.1 Assignments – Recordation of Conflicting Assignments

The report blurs the distinction about how notes and deeds of trust are transferred. The term "assignment" generally refers to the instrument that transfers the deed of trust, which is the conveyance of an interest in real property (serving as collateral for the loan used to finance the purchase of a home) from the original beneficiary to subsequent beneficiaries. A beneficiary may be the owner of the loan, but in most cases, the owner of the loan delegates that role to a third-party (usually Mortgage Electronic Registration Systems, Inc. ("MERS") or the loan servicer contracted to collect the payments). Use of the word "assignment" when dealing with transfer of the loan (represented by the promissory note), while commonly used, is generally inaccurate. Almost all promissory notes used in mortgage lending in the past 25 years are negotiable instruments and are not governed by a state's recording statutes. Negotiable instruments are governed by Article 3 of the Uniform Commercial Code ("UCC"), which has been adopted in all 50 states. As such, under the UCC, notes are transferred by negotiation (i.e., they are endorsed by the transferor and delivered to the transferee) rather than being transferred by an assignment instrument. In other words, an assignment of the deed of trust is in effect only a transfer of the lien securing repayment of the loan, together with the rights of a beneficiary to instruct the trustee to reconvey the deed of trust when the loan is paid-off or initiate a foreclosure if the homeowner is in default, and not a transfer of the loan.

The report concludes, that for a limited number of cases, there were two assignments of the same deeds of trust, and makes three inferences. First, that both cannot be valid, which might be true, but then goes on to say there is "strong possibility that neither *** is legally valid" without any support for the author's claim. This conclusion discounts that one of the assignments might have been done in error or incorrectly (making it a legal nullity), leaving the other to be a valid conveyance.

The author then implies that the mere presence of conflicting assignments undermines the foreclosure process and calls into "question whether the Beneficiary does in fact own the loan." This conclusion ignores the role of trustee who is the party who legally conducts the foreclosure process. The statement also reveals a major misunderstanding by the author of the lending process. As noted above, for most securitized loans, either MERS or the servicer is the record beneficiary of the deed of trust. They act in that capacity as agent of the owner of the indebtedness and have the authority to instruct the trustee to initiate the non-judicial foreclosure process. The ability of MERS or the servicer to act as the beneficiary has been upheld by many California court decisions at both the trial and appellate levels. *See Robinson v. Countrywide Home Loans, et al.*, Court of Appeals of the State of California, Fourth Appellate Dist., No. E052011(Riverside County Super. Ct. RIC526427)(Sept. 12, 2011); *Calvo v. HSBC Bank*, Court of Appeals of the State of California, Second Appellate District No. B226494 (Los Angeles County Super Ct. No. BC415545)(Sept. 13, 2011); *Gomes v. Countrywide Home Loans, Inc., et al.*, No. D057005, 192 Cal. App. 4th 1149 (Feb. 18, 2011), *review denied* (May 18, 2011), *cert. denied* (Oct. 11, 2011); *Fontenot v. Wells Fargo Bank N.A.*, State of California Court of Appeals, First Appellate District No. A130478 (Aug. 11, 2011) (Alameda County Super. Ct. No. RG09433189); *Earl A. Dancy v. Aurora Loan Services, LLC,* 2010 U.S. Dist. LEXIS 116513, *Knowledge Hardy v. IndyMac Federal Bank, et al*, 09-935 (E.D. Cal. 2009), *Baisa v. Indymac, MERS, et al*, 09-1464 (E.D. Cal. 2009).

Section 5.1 Assignments – Conflicts Between Federal Filings and Recorded Documents

The error noted in this section is that data in certain SEC filings about loan ownership does not match the county records. Ignoring that we cannot tell from the report what is being compared, there may be differences for two valid reasons: (1) the original lender may have appointed MERS or another party to serve as the beneficiary of the deed of trust on behalf of the lender and successive note owner(s) or (2) an assignment of the deed of trust may not have been filed. Neither of these reasons automatically invalidates the transfer of the loan to the trustee of the securitized trust nor compromises the foreclosure process. As noted above, negotiation of promissory notes is not governed by recordings in public land records and courts routinely recognize that MERS (or the servicer) is a valid beneficiary, holding the secured interest for the owner(s) of the loan. Furthermore, the pooling and servicing agreements expressly waive any possible requirement that an assignment of the deed of trust to the trustee be recorded when MERS is the beneficiary. Moreover, in a case where MERS is not the beneficiary, the lack of a recorded assignment by the seller may be a violation of the pooling and servicing agreement, but it certainly is not a violation of law.

Recording of assignments of the deed of trust are for the benefit of the creditor to provide public notice of the lien on the property serving as collateral for the loan and are not required by law to be recorded. This section also makes an unsubstantiated conclusion that conflicting assignments may "call into question whether the foreclosing beneficiary does in fact own the loan," which is not relevant in a foreclosure proceeding because the owner can delegate that function to its agent.

Section 5.1 Assignments – Assignments that are ostensibly executed by the Trustee or Servicer; Assignees Ostensibly Signing For Assignors

The report concludes that assignments were improper merely because a person employed by the trustee, servicer or assignee executed such assignments. This conclusion ignores a common practice in the industry where the deed of trust beneficiary has elected such an employee to be an officer of the beneficiary. The practice is legitimate and has passed the muster of the courts. There is also a statement that "The original owner or subsequent owner of the loan must execute the Assignment of the Deed of Trust," which is inaccurate for two reasons. First, it is the beneficiary that must execute the assignment of a deed of trust, and second, the beneficiary is not always the owner of the loan.

Section 5.3 Substitution of Trustee – Substitution Executed by an Entity Other Than The Beneficiary

The alleged violation in this section is that the "Substitution of Trustee was not executed by the Beneficiary of the loan," which the author later defines as the "actual owner of the loan." While the beneficiary of the deed of trust is the only party that can execute the substitution of trustee, as noted above, it is not required that the appointed beneficiary in the deed of trust be the owner of the loan because that owner is permitted by law to have an agent serve as the beneficiary on the owner's behalf.

Section 5.3 Substitution of Trustee – Other Suspicious Executions of Substitutions

This section is just another rehash of the spurious argument similar to those made in the other sections about execution of instruments. Under California law, there are also limitations on the ability to challenge the substitution of trustee.

<u>Section 5.5 Suspicious Activity and Other Issues – "Strangers" to the Deed of Trust Purporting to Be Beneficiaries</u>

Although it is not exactly clear what the author means by "stranger" in this section, there is an implication that the beneficiary needs to be the owner of the loan, which if that is the case, the author is wrong for reasons stated above.

<u>Section 5.6 MERS Conflicts and Results</u>

The characterization of MERS in this section is highly inaccurate and relies on many of the myths commonly asserted by less than informed critics. For example, despite the fact that the securitization market flourished for many years preceding the inception of MERS, it is claimed without any supporting information that "MERS played a unique role during *** the boom of the securitization market." The author also misstates the role that MERS plays in the secondary mortgage loan market. At closing, the homeowner (with the consent of the originating lender) makes MERS the beneficiary of the deed of trust as agent for the lender and the subsequent purchaser(s) of the loan; MERS becomes the agent in turn for each subsequent purchaser(s) of the corresponding promissory note. In other words, MERS holds the lien on behalf of the owner(s) of the loan. The deed of trust is recorded in the public land records and the appropriate recording fees are paid. With MERS, the chain of title is not broken; MERS ensures that there is no break because title to the lien remains with MERS from loan closing to the payoff of the loan (unless the lien is assigned from MERS at the instruction of the owner of the loan). The MERS legal process has been substantiated by federal and state courts throughout California: *Gomes v. Countrywide Home Loans, Inc., et al.*, No. D057005, 192 Cal. App. 4th 1149 (Feb. 18, 2011), *review denied* (May 18, 2011), *cert. denied* (Oct. 11, 2011); *Robinson-Hines v. U.S. Bank N.A.*, No. E050478 (Cal. App. 4th, Aug. 8, 2011; *Imelda T. Lomboy, v. SCME Mortgage Bankers; B.E.Z. Financial Network,, MERS, et al.*, 09-1160 (N.D. Cal. 2009), *Labra v. Cal-Western Reconveyance Corp.,* 09-2537, (C.D. Cal. 2010); *Pantoja v. Countrywide Home Loans, et al.*- US Dist. Ct., 5:09cv016015 (N.D. Cal., 2009).

As discussed earlier, implicit throughout the report is the theme that the owner of the loan must somehow appear in the public land records. The ownership of the loan is represented by the promissory note, which is a negotiable instrument (i.e., personal property), and is not a conveyance of an interest in real property. Thus, the transfer of the loan is reflected by the endorsement and delivery of the physical instrument, and not by assignment of the note recorded in the land records. The purpose of public land records is to protect the rights of creditors by putting interested parties on notice of the *existence* of a lien interest—the lien priority and amount of represented value against the property and who to contact for information regarding the lien. Members of the public who have no interest in the real property have no cognizable right to a homeowner's private information, such as the identity of who a homeowner makes his loan payments to, or who owns the indebtedness.

In the report, the author makes the claim that "transfers between two MERS members is effectively unknown to those outside the MERS system" and that homeowners need access to the identity of the owner of his or her loan by virtue of the public land records. What the author conveniently ignores is that homeowners have had access to identity information for some time as it is guaranteed to homeowners under federal law. Federal law requires: (1) each time a mortgage loan is sold, that the homeowner be provided with the name of the purchaser within 30 days of when the loan was sold, and (2) that the servicer disclose the name of the owner of the loan to the homeowner within 10 days of receipt of a written request for such information. The public at large has no independent right or interest in such private information related to an individual homeowner.

Separate from the above federal protections, since inception, MERS has provided free access (first, through a toll-free telephone number and later supplemented though a internet based solution) to the name and contact information for the servicer, and more recently, for 98% of the over 32 million active loans on the system, the owner of the loan will be disclosed to the homeowner by a toll free number or via the internet. The notion that homeowners need to know who owns their loan in order to obtain a modification ignores the fact that the owner of the loan generally cannot help homeowners because investors do not maintain the homeowner's loan files and have no ability to make loans; loan administration has been contracted and delegated to the loan servicer, and that is the party who the homeowner needs to contact.

The methodology used in the report to claim that the information on the MERS® System is inaccurate is flawed. Mainly, because the authors believe that the owners of the loan (defined as investors in the MERS® System) need to be the foreclosing beneficiaries, but as noted several times above, investors are not required to conduct foreclosures directly, instead they can delegate that authority to their agents (like MERS and the servicers). Thus it is not surprising that the comparisons made by the author between the MERS® System and the land records did not match. Also, particularly during the early portion of the time span used in the audit, there may have been instances where the servicer (or an affiliate of the servicer) was permitted to be in the "investor" field, rather than the securitization trustee. This practice is no longer permitted, however, it certainly was not a violation of any California law nor did it give rise to any damage to the homeowner.