

17th Annual Advanced Real Estate Drafting Course

Commercial eMortgages: Get Ready, Get Set,

Presented by:



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- **BIG Picture**
- **Commercial Mortgage Lending Industry:**
"coming soon from an industry near you"
- **Legal Framework**
- **eMortgage and eFriends (not a sitcom)**
- **Challenge and Hurdles**
- **Footnotes and Resources**

The "BIG" Picture



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The "BIG" Picture

THE END

*(Thank you for your short but
rapt attention.... we now
return you to your regular
[boring] program)*

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The "BIG" Picture

- ▶ Remember – Change is our friend
- ▶ What do these tasks have in common?
 - "first day" school packets
 - a Wal-Mart vendor
 - grocery store checkout
 - airline travel reservations
- ▶ Answer: "electronic" information and "agreements"
 - more than a trend – a reality
 - an electronic process and deliverable

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The "BIG" Picture

- "There are consumers, and there are investors, and the rest is **friction**."
 Angelo Mozilo, Chairman & CEO
 Countrywide Financial Corporation
- "Technology is altering the structure, products and processes of the U.S. real estate finance system"
 Douglas Duncan, SVP and Chief Economist
 Mortgage Bankers Association
- Real Estate: just another commodity (piece of data)
- Huge Appetite/Demand For Data: transparency
 - Capital markets
 - public policy and legislation

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“Coming Soon.....”

- ▶ **What do these industry organizations and companies have in common?¹**
 - ❖ Mortgage Bankers Association of America (“MBA”)
 - ❖ Mortgage Industry Standards Maintenance Organization (“MISMO”)
 - ❖ United States Notary Association; National Notary Association
 - ❖ Standards and Procedures for Electronic Records and Signatures (“SPeRS”)
 - ❖ Property Records Industry Association (“PRIA”)
 - ❖ Mortgage Electronic Registration System Inc. (“MERS”)
 - ❖ Freddie Mac
 - ❖ Fannie Mae
 - ❖ American Land Title Association
 - ❖ National Conference of State Legislatures

"Coming Soon....."

► Why change?

- ❖ move from document access to information exchange: faster closings and transmission of information (speed)
- ❖ increased data integrity: more accurate transmission of information (8 times)
- ❖ lower operational costs; higher profitability
- ❖ more liquidity (put \$ to work faster; ↓ risk in pricing)
- ❖ reduced risk: process automation implements quality, control (business rules)
- ❖ people review only "exception cases"
- ❖ increase asset value

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"Coming Soon....."

► What will change?

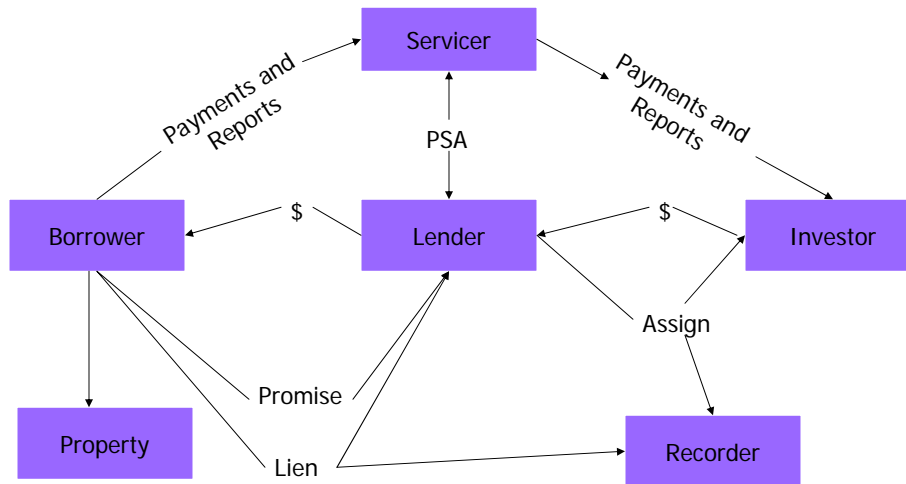
- ❖ "documents" used to close a loan (collectively, the "eMortgage")
- ❖ the words we use
- ❖ the business process

► A new way of thinking:

- ❖ Old way – bad, passé
- ❖ New way – good, avante garde

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"Coming Soon....."



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"Coming Soon....."




- ▶ Loan Documents
 - Note
 - Mortgage
 - Guaranty
 - UCC-1
 - Reserve Agreements
 - Assignments
 - Etc.
 - Etc.

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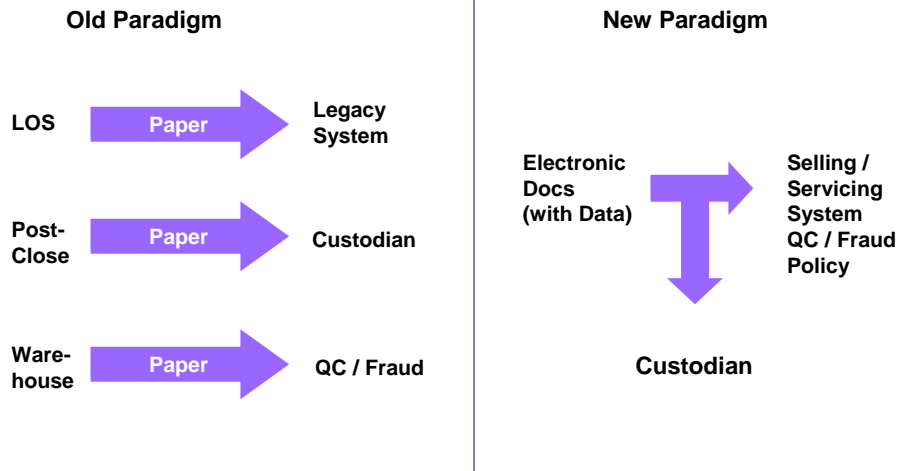
"Coming Soon....."



"Coming Soon....."

- ▶ Data is King 
- ▶ Transparency is Queen 
- ▶ Disruption is Crown Prince 

"Coming Soon....."



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"Coming Soon....."

Paper World → Electronic World

Negotiable Instrument	Transferable Record ("eNote")
Original Note	Authoritative Copy of eNote
Possession	Control
Investor/Holder	Controller
Custodian	Location (eVault)
Endorsement	Transfer of Control
Holder in due course	Transferable Record Audit trail
Servicer	Controller's Delegatee

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"Coming Soon....."

Recent Milestones:

- **MERS Commercial Note eRegistry**
- **Servicing Transfer**
- **XML Version of the CMSA-IRP**
- **Superset Chart of Accounts**
- **Electronic Third Party Reports**
- **Commercial eMortgage – Digital Signature Requirements for Commercial Entities**
- **Commercial Loan Document Index**

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- **BIG Picture**
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Legal Framework

- ▶ **“Electronic” signatures:** recognize an electronic symbol or process as evidence of an intent to sign a “record” by a party
- ▶ **State Laws: in place, either by -**
 - ❖ adoption of the Uniform Electronic Transaction Act (“UETA”) (1999) (National Conference of Commissioners of Uniform State Laws)
 - ❖ specific state electronic signature laws
- ▶ **Problem with UETA: slow, inconsistent state adoption**

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Legal Framework

- ▶ **Federal Law: Electronic Signatures in Global and National Commerce Act (“ESIGN”) (2000)**
 - ❖ no change in substantive law
 - ❖ covers state and federal laws
 - ❖ technology “neutral”
 - ❖ gives legal effect to “electronic signature” and “electronic records”
- ▶ **ESIGN is:**
 - ❖ an overlay statute
 - ❖ general rule: electronic signature can not be denied solely due to being in an electronic form

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Legal Framework

► What is an E-Mortgage?

"A mortgage where the critical loan documentation - - - specifically, the promissory note, assignments and security instrument - - - are created electronically, transferred electronically and ultimately stored electronically."²

► **Uniform Real Property Electronic Recording Act (Summer 2004)** (Approved by the National Conference of Commissioners on Uniform State Laws)

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eMortgage, eFriends

- **A Paperless Product**
- An Electronic Process
- An Industry Protocol

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eMortgage, eFriends

A Paperless Product - The SMART Doc

- ▶ A SMART Doc is
 - **S**ecurable
 - **M**anageable
 - **A**rchivable
 - **R**etrieveable
 - **I**ransferable

[Open: Use of Adobe PDF]

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eMortgage, eFriends

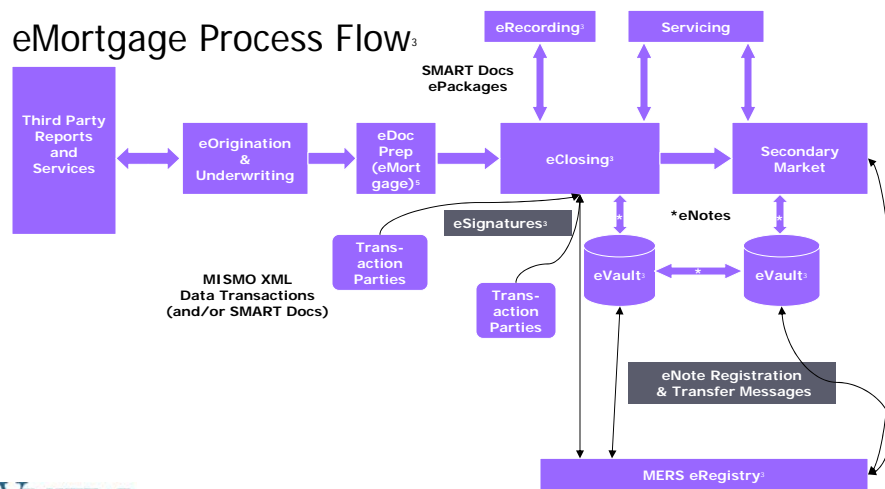
What is an E-Mortgage?

- ❖ A Paperless Product
- ❖ An Electronic Process
- ❖ An Industry Protocol



eMortgage, eFriends

eMortgage Process Flow³



eMortgage, eFriends

What is an E-Mortgage?

- ❖ A Paperless Product
- ❖ An Electronic Process
- ❖ **An Industry Protocol**

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eMortgage, eFriends

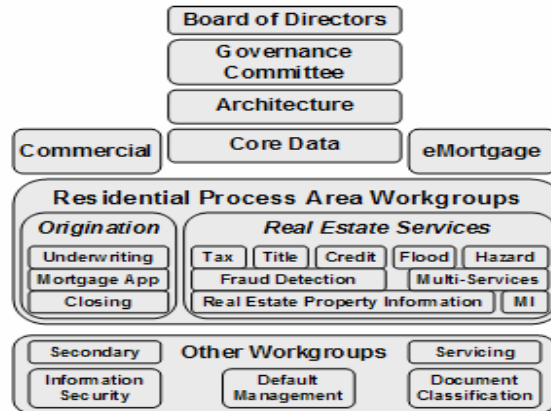
The MISMO Mission

- The Mortgage Industry Standards Maintenance Organization's mission is to develop, promote, and maintain voluntary electronic commerce standards for the mortgage industry.
- Established in 1999 by the Mortgage Bankers Association, MISMO encourages participation from all sectors of the industry.

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Simplified MISMO Organization:



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Scope of MISMO v1.0 SMART Doc Specifications

- The MISMO SMART Document Specification provides a set of building blocks that can be used to combine a view, data, and electronic signatures into an electronic document.
- The MISMO SMART Documents can be packaged into sets related documents such as an electronic loan file.

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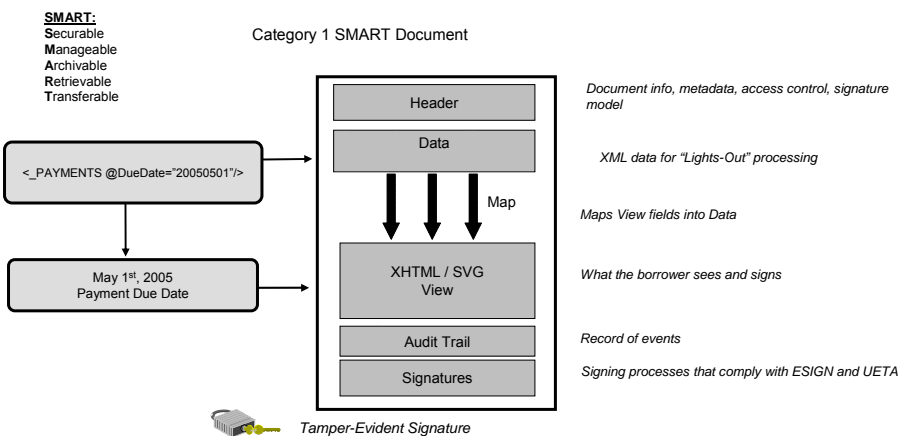
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What is a SMART Doc?

- ▶ It has two basic components:
 - The "Framework" which includes:
 - ❖ A "Header" containing basic document information
 - ❖ A "View": what tomorrow sees and signs
 - ❖ "Electronic Signatures" used to seal the document
 - The "Data"

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eMortgage, eFriends



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eMortgage, eFriends

- Smart_Document (Header)

```
<?xml version="1.0" encoding="UTF-8"?>
<!DOCTYPE SMART_DOCUMENT SYSTEM
  "SMART_DOCUMENT_V_1_02.dtd">
<SMART_DOCUMENT MISMOVersionIdentifier="1.02"
  PopulatingSystemDocumentIdentifier="FNMA_Sample_3200">
<HEADER _ID="FNMA_Sample_Header_3200">
<DOCUMENT_INFORMATION _Type="Note"
  _StateType="Populated" NegotiableInstrumentIndicator="True"
  MustBeRecordedIndicator="False" _FormNumberIdentifier="3200"
  SMARTDocumentCategoryType="1"/>
```



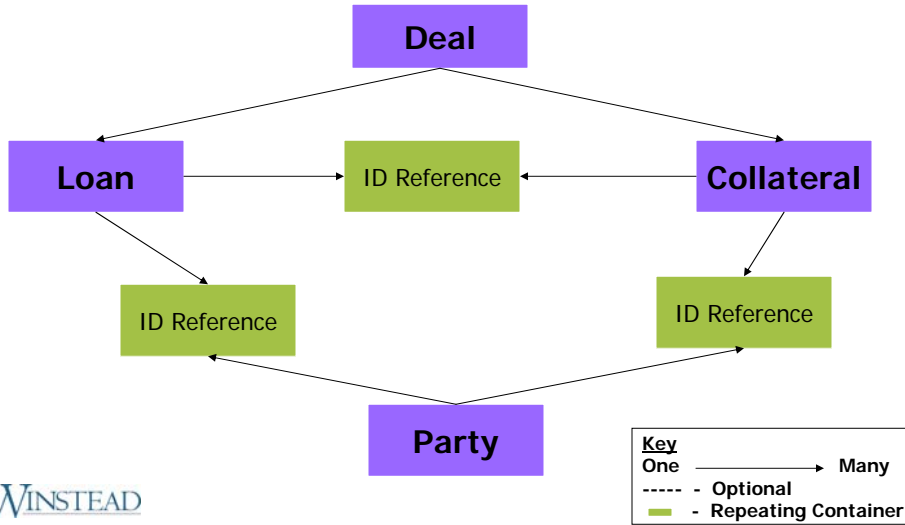
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- Smart_Document (View)

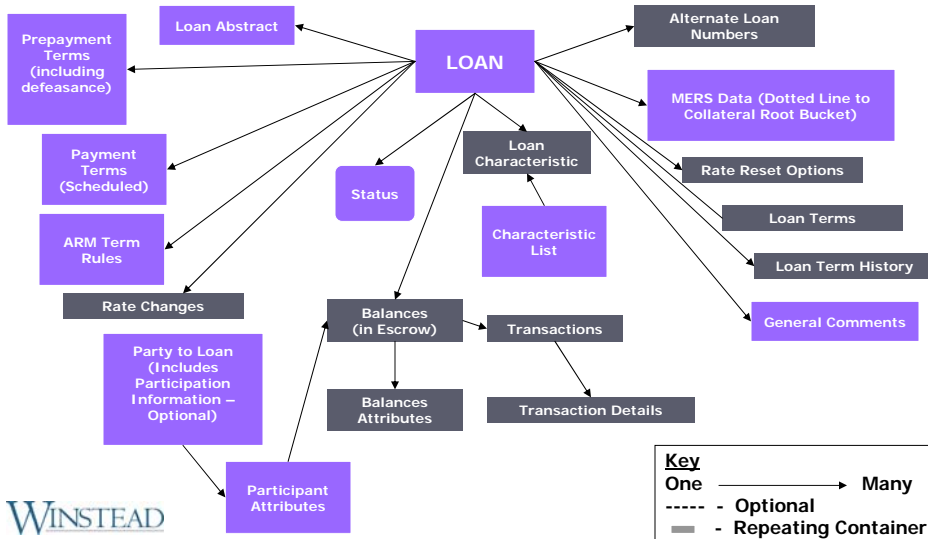
```
<h2>1. BORROWER'S PROMISE TO PAY </h2>
<pre class = "justify">In return for a loan that I have received, I
  promise to pay U.S.
<span class = "dataEntered" id = "MORTGAGE_TERMS-
  OriginalLoanAmount">$96,500.00</span><span class =
"dataEntered"> </span> (this amount is called
  &quot;Principal&quot;),<br/>plus interest, to the order of the
  Lender. The Lender is <span class = "dataEntered"> </span><span
  class = "dataEntered" id = "LENDER-
  _UnparsedName">Columbia National Incorporated</span><span
  class = "dataEntered">
```



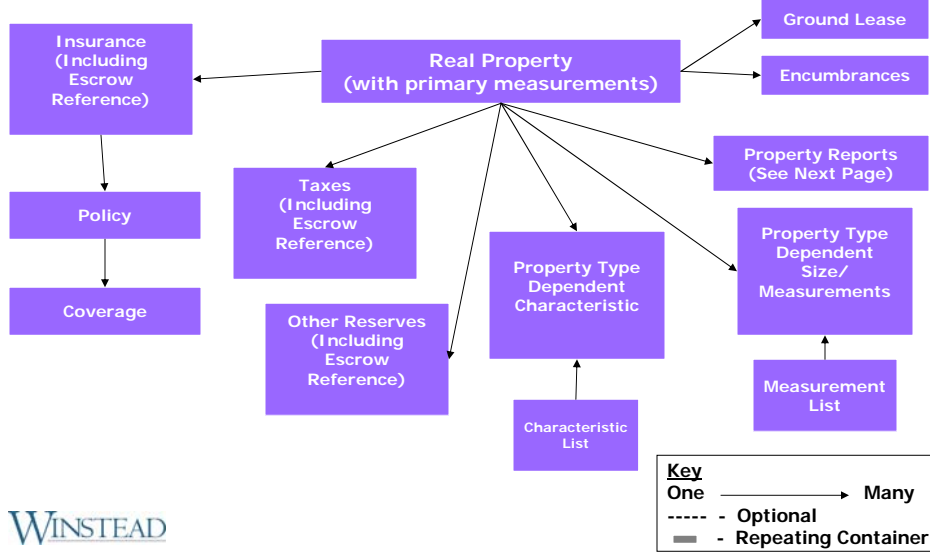
eMortgage, eFriends



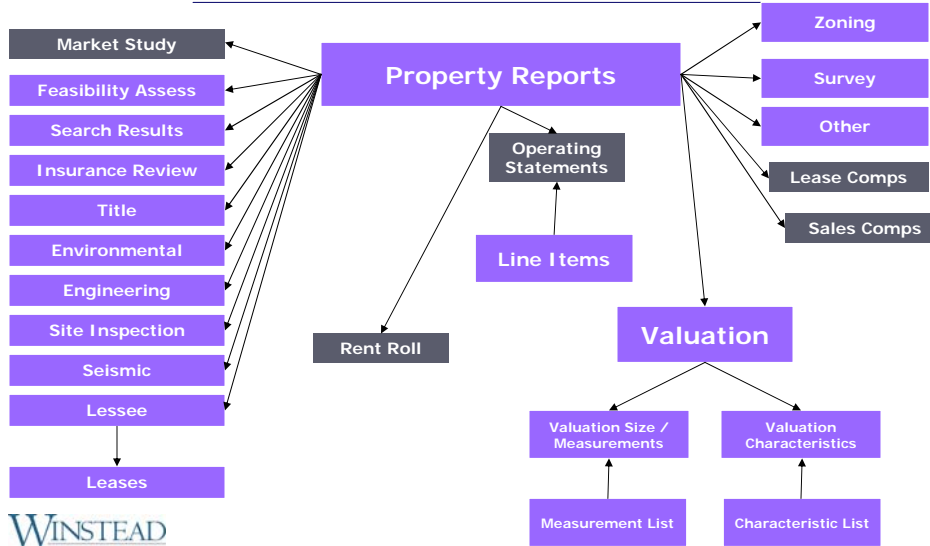
eMortgage, eFriends



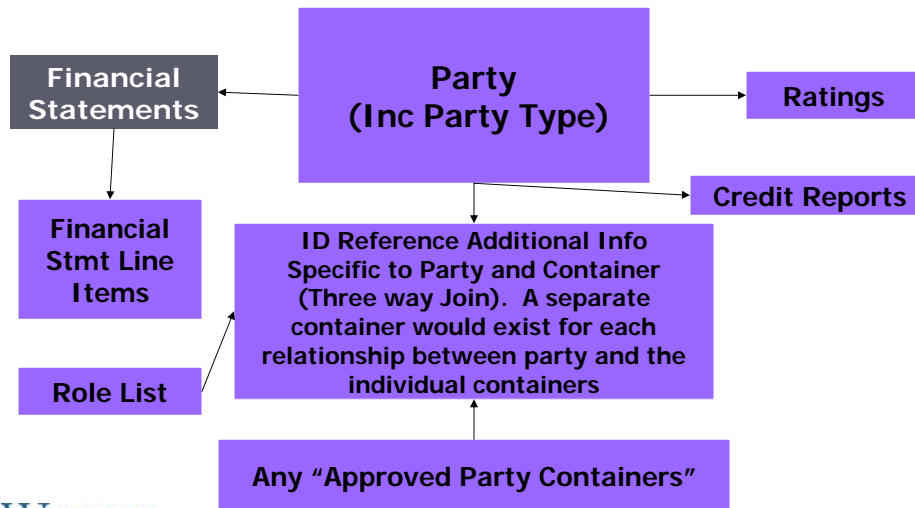
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What is XML?

eXtensible Markup Language

- ▶ eXtensible – provides open architecture to design your own XML
- ▶ Markup – a method for “decorating” information about data or text
- ▶ Language – provides a syntax and grammar that can be understood

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What is XML?

- ▶ XML provides a means to transfer data from application to application in a well defined unambiguous manner
- ▶ XML is self-describing
- ▶ XML is platform neutral

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What is XML?

XML Is A Way To "Structure Data"

- ▶ Well-formed
 - XML has it own grammar
 - An XML document must adhere to this grammar
- ▶ Valid
 - Can be validated against a DTD or Schema
 - Ensures that the XML document is consistent

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What does XML Look Like?

Say you are sending the following data to someone:

MyLoan #999999

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What does XML Look Like?

The XML Document would look like:

```
<MyData>
  <LoanName>My Loan</LoanName>
  <LoanID>999999</LoanID>
</MyData>
```

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More on XML

XML Is Becoming The Preferred Method of Data Interchange

- ▶ **Technical Dimension**
 - A tool for machine-to-machine data transfer
 - Extremely flexible
- ▶ **Business Dimension**
 - Human Readable
 - Easy to create and send XML Documents (even a CEO can do it!)

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What is MERS?

MERS is an industry utility created by the MBA to promote electronic commerce and eliminate paper-based processes.

- ❖ MERS eliminates the need to prepare and record paper assignments when selling loans between MERS® Ready members.
- ❖ MERS operates the MERS® eRegistry to provide liquidity for electronic notes.

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What is MERS?

Mortgage Electronic Registration Systems, Inc. (MERS) is the legal entity that is recorded in the county land records as mortgagee for loans registered on the MERS® System.

MERS is a bankruptcy remote subsidiary of MERSCORP, Inc. which operates the MERS systems and processes.

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Who Owns MERS?

- | | | |
|-------------------|----------------------|----------------|
| ▶ Fannie Mae | Freddie Mac | WMC |
| ▶ MBA | ABN AMRO | Wells Fargo |
| ▶ EverHome | Charter One | ALTA |
| ▶ Chase | CitiMortgage | AIG UG |
| ▶ Corinthian | Countrywide | CMSA |
| ▶ GE Capital | Guaranty Residential | First American |
| ▶ HSBC | Merrill Lynch | MGIC |
| ▶ Nationwide Home | GMAC/RFC | PMI |
| ▶ SunTrust | WaMu | Stewart Title |
| ▶ WMC | Wells Fargo | |

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How Does It Work?

- ▶ **The security instrument names MERS as mortgagee and nominee for the lender.**
- ▶ **MERS serves as mortgagee in the county land records for MERS members.**
 - When servicing transfers from one MERS member to another, no assignment is needed because MERS remains the constant mortgage lien holder over the life of the loan.
 - Chain of title is simplified because it begins and ends with MERS.

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How Does It Work?

- ▶ **Members register loans on the MERS® System and then report transfers of beneficial and servicing interests as they occur.**
- ▶ **MERS receives service of process and electronically forwards documents to the current servicer on the MERS® System.**
- ▶ **Members foreclose and release liens in the name of MERS through our corporate resolution naming their officers as MERS officers.**

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MERS as Original Mortgagee

- ▶ **Sample “MOM” Language appearing on the security instrument:**
 - MERS (“Mortgage Electronic Registration Systems, Inc.”) is a separate corporation that is acting solely as nominee for Lender and Lender’s successors and assigns. MERS is the Mortgagee under this Security Instrument. MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, Tel, 888-679-MERS.

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MERS for Residential Loans

- ▶ **Over 30 million loans registered since 1997**
- ▶ **Average 24,000 loans registered daily**
- ▶ **Over 2400 companies actively using MERS**
- ▶ **Over 53% market share on all newly originated loans in the U.S.**
- ▶ **Accepted by all major secondary market investors and routinely included in rated securities.**

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MERS Commercial

- ▶ Same legal foundation as MERS for residential loans
- ▶ System adapted for cross collateralized loan products
- ▶ Over \$20 billion (1000 loans) registered since July 2003
- ▶ Live on MERS® Commercial:
 - Bear Stearns Banc of America Securities
 - Wells Fargo Ginnie Mae
 - Pinnacle Fin. RESMAE
 - LaSalle
- ▶ Other lenders in the pipeline:
 - Lehman Morgan Stanley
 - GE Capital Midland Loan Services

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Challenges & Hurdles

- Electronic recording at counties
- Powered by volunteers
- Competing and legacy technology
- Lawyers (yes, you!)

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Footnotes

Contributors to this presentation: Dan Szparaga with the Mortgage Bankers Association; Jim Cooke with Ballard Spahr Andrews & Ingersoll, LLP; and Dan McLaughlin with MERS

1. Slide #8:

www.mortgagebankers.org

www.mismo.org

www.enotary.org

www.nationalnotary.org

www.pria.us

www.mersinc.org

www.ncsl.org

www.spers.org

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Footnotes

2. Slide #16: MISMO, [Glossary of Terms, Version 1.1](http://www.mismo.org) (www.mismo.org)

3. Slide #26: The following definitions appear in the MISMO eMortgage Guide (www.mortgagebankers.org)

eSignatures: is defined as an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.

eClosing: is defined as the act of closing a mortgage loan electronically. This occurs through a secure electronic environment where all closing docs are accessed and executed via the Web. This is also known as the 'execution' phase of creating an electronic mortgage loan.

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Footnotes

3. Slide #26: Definitions – continued:

eMortgage: The eMortgage framework and standards are based on key industry standard concepts that allow the mortgage documents to be generated, transferred, signed, sealed, registered, and stored electronically, eliminating the need for printing, imaging, shipping, couriers, data re-entry, manual data certification, and other costly steps of today's mortgage processes.

eVault: The term "eVault" is typically used in the mortgage industry today to describe where electronic documents are stored for safekeeping. However, to date, there is no comprehensive and authoritative source that defines requirements and responsibilities for implementing and operating an eVault on the behalf of lenders, warehouse lenders, or investors.

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Footnotes

3. Slide #26: Definitions – continued:

MERS eRegistry: Mortgage Electronic Registration Systems, Inc. ("MERS") is a mortgage industry utility that eliminates the need to prepare and record assignments of mortgages when trading mortgage loans. Borrowers name MERS as mortgagee and nominee for the lender on deeds of trust and mortgages that are recorded in the public land records. Lenders then register the loans on the MERS® System and electronically track changes in servicing and investor ownership rights over the life of the loan.

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Footnotes

3. Slide #26: Definitions – continued:

eNote: an electronic promissory note. The mortgage note is a promissory note that creates a legal obligation of the borrower to repay the debt secured by the mortgage. The note is structured to be negotiable. This allows the mortgage lender to assign the loan upon sale into the secondary mortgage market. Once the debt is repaid in full, a notice of satisfaction is recorded. This clears the lien from the property's title.

Transferable Records: exist when there is a single authoritative copy of that record existing and unalterable in the "control" of a person. Section 16(d) of UETA provides that a person in "control" is a "holder" for the purposes of transferring or negotiating that record under the UCC.

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Footnotes

3. Slide #26: The following summarizes the opportunities and related benefits using the SMART document specification:

Opportunity	Benefits
eCompliance	Replaces manual quality control and compliance checks with automated checks throughout the process, which will improve loan quality and shorten cycle times.
eDisclosure	Eliminates manual preparation and shipping of application and initial disclosure packages to/from the borrower(s).
eNote	Eliminates shipping, manual data reentry, manual data certification, and imaging of the investor collateral packages. With intelligent workflow, the eNote also enables a significant reduction in the closing and funding cycles.

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Footnotes

3. Slide #26: The following summarizes the opportunities and related benefits using the SMART document specification (continued):

Opportunity	Benefits
eClosing	Eliminates the manual scheduling of closings and shortens cycle time of overall closing processes; data is shared by all in the service supply chain, which eliminates redundant data entry and errors.
eDelivery	Reduces document management overhead, shortens cycle times, and improves overall process efficiencies with secure electronic delivery of mortgage-related documents.



Footnotes

3. Slide #26: The following summarizes the opportunities and related benefits using the SMART document specification (continued):

Opportunity	Benefits
eRecording	Improves the real estate recording process, reduces overall cycle time for all participants and reduces the costs for both county recorders and their customers.
eServicing	Lowers costs and improves customer service for all business partners as companies begin to leverage the MISMO standards to move Investor Reporting, Delinquency Reporting, and other traditional servicing tasks to a collaborative Internet environment.



Resources

- MISMO Commercial eMortgage Workgroup, Commercial eMortgages: The President and Future of "Paperless, Transactions in Commercial Mortgage Lending" (May 2003)
(available at www.mismo.org/files/MISMO/CommercialeMortgagesPositionPaperreleaseMay2003.pdf)
 - ❖ great resource: www.mismo.org
- Freddie Mac eMortgage Handbook, Version 1.0 (available at www.freddiemac.com/singlefamily/elm/pdf/eMortgage_Handbook.pdf)
- SPeRS: a cross-industry initiative to establish "rules of the road" for implementing ESIGN and UETA (available at www.spers.org)