The MERS project. (mortgage electronic registration system)

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Mortgage Banking

Progress is being made on an ambitious plan to strip more paper out of the mortgage business. Under the MERS plan, an electronic registry would be created to track changes in ownership interests for mortgages and servicing.

MERS STANDS FOR THE MORTGAGE ELECTRONIC REGISTRATIONS SYSTEM, but what it may eventually stand for is relief from cumbersome and expensive paper processing. The MERS concept calls for developing an electronic registry to be used for transferring and releasing ownership and security interests in mortgages. Such a system would virtually eliminate the need for paper mortgage assignments. The MERS registry would identify the interests of originators, servicers, mortgage investors and warehouse lenders essentially on a real-time basis. * The MERS concept was formally introduced in October 1993 at the annual convention of the Mortgage Bankers Association of America (MBA) when MBA's InterAgency Technology Task Force published the Whole Loan Book Entry White Paper. The task force consists of representatives from Fannie Mae, Freddie Mac, GNMA, and MBA. Since late 1993, although the name of the project has changed from Whole Loan Book Entry to MERS, development work has been ongoing. * By working within the existing legal framework, the project seeks to reduce the costs and inefficiencies created by the current need to execute, process and track mortgage assignments to establish transfers of ownership, pledges of security interests in mortgages, sales of mortgages to investors and transfers of servicing rights. Assignments are creatures of 17th-century real property law; they do not coexist easily with high-volume, late 20th-century secondary mortgage market transactions.

The MERS concept builds on the experience of other industries in applying information technology to reduce processing costs. Thirty years ago, stock and bond registration and trading were done primarily in a paper-based system. Stock and bond certificates were issued to investors to evidence ownership of securities. Each time a security was bought or sold, the original paper certificate was destroyed and a new certificate was issued to the buyer. As trading volumes increased over time, the paperwork became unmanageable, causing delays in trade settlement dates. Because of these problems, the securities industry began to implement book-entry systems to streamline the process, eventually reducing costs by more than 90 percent.

The plan calls for MERS to be an open system, available to all secondary market investors, including conduits and other private mortgage investors, as well as other interested industry participants, such as portfolio lenders and title and mortgage insurers. As described in the October 1993 White Paper, it will be a not-for-profit, member-owned entity. Initially, MERS will be targeted at residential mortgages. However, the concept may be applied in the future to multifamily and commercial loans.

The electronic registration concept

The current concept has several elements. First, a loan would receive a permanent, loan-identification number as early in the process as loan application (or as late as loan closing, depending on the needs of the originator or wholesaler). Secondary market investors, as well as FHA and other interested entities, would accept that loan number and phase out their own loan numbering systems. Work on developing this Mortgage Identification Number (MIN) already has begun with the participation of service bureaus, software vendors and mortgage banking companies.

Next, consistent with the current mortgage process, a paper mortgage would be executed and recorded in the public land records. An assignment of the mortgage to MERS also would be recorded. (Absent a default, this would generally be the only paper assignment required for the life of a loan.) The loan would be registered with MERS upon loan closing, (or earlier, depending upon the preference of the originator/wholesaler).
After registration, the initial document custodian (most likely the document custody facility of the warehouse lender) could hold the mortgage note on behalf of all those with subsequent interests in the loan. During the life of the mortgage, the various interests and their release would be reflected in MERS via electronic transmissions.

Because the mortgagee of record (MERS) would not change while the loan is current, there would be no need either to execute or record in the public land records any assignments to reflect the sale of the mortgage to an investor, the creation or release of the warehouse lender’s interest, or the transfer of servicing rights. However, if a loan must be foreclosed, legal title would have to be vested in the current servicer.

Benefits of the MERS concept

* Eliminates the need for subsequent assignments following the origination and closing of a loan. Clearly, the MERS concept would reduce costs by eliminating the preparation, tracking, shipping and recordation of most mortgage assignments.

* Significantly simplifies the loan-tracking process. Use of a permanent, universal Mortgage Identification Number will allow easy tracking of loans during their lifetime. Large wholesalers, in particular, will be able to use MERS to track the status of their loans, (i.e., closed, received from settlement agents, received by document custodian.) If all investors and mortgage insurers and lenders agree to use the Mortgage Identification Number, various reengineering efficiencies also may be achieved.

* Improves the lien-release process. The MERS clearinghouse can be used to facilitate the lien-release process, which takes on average 10 to 12 weeks and can take as long as a year or more. under MERS, servicers can perform the necessary due diligence and notify the clearinghouse (as mortgagee of record) to generate a release document; communications between settlement agents and lenders can be handled via e-mail.

* Assists in fraud reduction. Using the Mortgage Identification Number and certain other information, such as property address, will provide a cross-referencing capability that will attempt to avoid multiple loan fundings.

* Simplifies procedures for delivering legal notice by providing an accurate data base of mortgage rights. MERS is intended to exist concurrently with the local public land records. Presently, the public land records do not necessarily identify the current mortgage servicer, thus complicating the delivery of legal notices required to be sent to the mortgagee of record, (e.g., notice of Junior lien foreclosure actions). MERS as the mortgagee of record will receive the requisite legal notices and be able to provide an orderly mechanism to assure that servicers and subservicers are informed of pending legal actions.

* Reduces cost through voluntary note immobilization. Note immobilization will reduce shipping and probably recertification costs. However, note immobilization will not be mandated. The MERS concept, as initially described in the White Paper, envisioned active incentives for immobilization through developing standardized document custodian eligibility requirements or ratings to increase confidence in any particular custodian. It soon became apparent that the approach was raising barriers to acceptance of MERS because of servicer reservations about interference with existing relationships. Accordingly, the MERS project team decided to delete formal note immobilization incentives from the initial phase of the MERS project.

Electronic data interchange

Although the MERS project is fundamentally a business process redesign project, the project definitely involves technology. The concept is predicated upon electronic data interchange (EDI). The mortgage banking industry is embracing EDI to bring greater levels of efficiency to the industry. EDI allows business partners to communicate electronically, although the parties operate different computer systems. EDI permits two computer systems to talk by using standardized formats for transmitting data and special translation software. Participants will be able to use the MERS clearinghouse merely with a personal computer, a modem and translation software. EDI will be a key ingredient to the success of MERS. Work is now under way to develop an EDI standardized format for mortgage note information as well as the Mortgage Identification Number.

Industry-wide effort

What sets this project apart from most other technology initiatives is that it is a nonproprietary industry-wide effort to address industry-wide concerns. To date, Fannie Mae, Freddie Mac and MBA have provided funding for the project, although the Department of Housing and Urban Development (HUD) through FHA and GNMA has been actively involved in the MERS Steering Committee, which has been providing leadership for the project. Representatives of related trade groups and others also have engaged in the planning process by participating in MERS work teams and focus groups.

Fannie Mae and Freddie Mac have indicated their strong continuing support for the project. However, they are looking for
mortgage companies, banks and others to commit to an active role, as efforts move forward to make MERS a reality.

Industry response

To date, industry response has been very positive. Mortgage bankers see a real benefit in the virtual elimination of paper mortgage assignments. (See The Assignment Problem).

An opportunity to hear industry reactions to the concept was presented at a meeting sponsored in July 1994 by Fannie Mae, Freddie Mac and MBA. This meeting, known as the Westfields Conference, brought together the various segments of the mortgage banking industry. These included secondary-market investors; warehouse lenders; document custodians; mortgage originators and servicers; trade groups, and the federal financial institution regulators, who met to discuss the concept and its implementation. The interested trade groups included America’s Community Bankers, the American Bankers Association, the American Bar Association, the American Escrow Association, and the National Association of County Clerks and Recorders.