

U.S. Regulators Examining Departures at Mortgage Registry

By Jesse Hamilton - Apr 16, 2014

As the rest of the housing industry recovers, a little-known firm with a key role in U.S. mortgage finance remains stuck in limbo, wrestling with regulators, lawsuits and the departures of senior employees.

The turbulence feeds uncertainty about the fate of [Mortgage Electronic Registrations Systems Inc.](#), or MERS, which documents the ownership and resale of about half of U.S. home loans. A breakdown could force clients such as [Fannie Mae \(FNMA\)](#) and [Bank of America Corp.](#) to make costly changes to their loan businesses.

Management hasn't completed fixes promised in a broad 2011 U.S. settlement designed to stop foreclosure abuses, according to two people briefed on MERS' operations. Regulators rejected one of the firm's consultants as unqualified and are examining why four employees hired to help with reforms -- including the chief legal officer -- recently quit, said the people, speaking on condition of anonymity because the matter is private.

The closely held Reston, Virginia-based firm, a unit of Merscorp Holdings Inc., is also facing scores of lawsuits and state probes that challenge its business model as well as the legality of its filings in hundreds of county courthouses.

"Merscorp Holdings Inc. has an unwavering commitment to work with regulators under the consent order and to take all necessary steps to make the company and our members stronger," President and Chief Executive Officer Bill Beckmann said in an e-mailed statement. He said the company can't comment on personnel or its communications with U.S. agencies.

The biggest customers of MERS are also owners: Fannie Mae, Freddie Mac (FMCC) and Bank of America. Others with stakes include Wells Fargo Inc., [Citigroup Inc. \(C\)](#) and the [Mortgage Bankers Association](#).

'Certain Defects'

"If the use of MERS is found not to be valid, we could be obligated to cure certain defects or in some circumstances be subject to additional costs and expenses," Bank of America reported in a February filing. "Our use of MERS as nominee for the mortgage may also create reputational risks for us."

Fannie Mae, in its annual financial report filed in February, also noted the potential effects if the lawsuits or regulatory pressures force changes in MERS.

"A large portion of the loans we own or guarantee are registered in MERS's name and the related servicing rights are tracked in the MERS System," [Fannie Mae's](#) report said, adding that if the firm couldn't function in the same way, lenders could be forced to go back to time-consuming and expensive methods of recording land transfers.

Faster Paperwork

U.S. mortgage lending contracted in the first quarter of 2014 to \$226 billion, as [interest rates](#) rose and credit standards tightened, the lowest amount of lending since 1997, according to the Mortgage Bankers Association. Still, the housing finance industry is far healthier than it was after the 2008 credit crisis, with foreclosures and delinquent loans abating and profits surging at Fannie Mae and [Freddie Mac](#).

The year 1997 also happens to be when the MERS system began operating. It was established by the industry to speed up real-estate paperwork, especially changes in ownership and servicing rights for loans, a process previously done by hand in local jurisdictions. Instead of firms sending representatives to each courthouse, MERS began to stand in for them.

"There's a kernel of a good idea in there, but it was done so sloppily," [Ira Rheingold](#), executive director of the National Association of Consumer Advocates, said of the digital registry. "It really became quite a mess."

Popping Bubble

Investors could buy loans more easily under the electronic MERS system, which helped feed Wall Street's growing appetite for securitization -- the bundling of loans into packages of investments. That, in turn, helped inflate the housing-price bubble that popped in 2008.

MERS quickly found itself caught between the industry that created it and borrowers losing their homes -- many of whom hadn't heard of MERS until they received foreclosure notices. The crush of home seizures exposed flaws in the paper trail and lax control over the massive list of "certifying officers" MERS used to execute documents in its name.

U.S. investigators later accused the banks, mortgage brokers and MERS of failing to properly track loan ownership in many cases, and permitting "robo-signing" of documents that threw the legality of some transactions into doubt.

'Unacceptable' Risks

The case led to a \$10 billion federal settlement last year in which the loan servicers agreed to send cash to borrowers who'd been subject to flawed foreclosures.

A related probe by federal officials found that MERS exposed its clients to "unacceptable operational, compliance, legal and reputational risks" by having weak oversight of the documentation, improper corporate governance and insufficient legal expertise devoted to the system.

While the company didn't admit wrongdoing, MERS agreed to an order from its bank members' regulators -- the [Federal Reserve](#), Office of the Comptroller of the Currency, Federal Deposit Insurance Corp. and the [Federal Housing Finance Agency](#) -- to fix faults that let it become a platform for robo-signing. It promised to beef up its staff and revamp practices based on the recommendations of consultants.

At least four of those subsequently hired by MERS -- the firm's chief legal officer, its national litigation coordinator, its corporate counsel and its chief internal auditor -- have now departed, the people briefed said. They exited before MERS has been cleared from its settlement obligations, and the federal overseers have been scrutinizing their absence, the people said.

Consultant Rejected

Beckmann, the MERS CEO, said the company couldn't discuss employee matters. Michael B. Skalka, the chief legal officer and the most senior of those who left, declined to comment.

Friction between MERS and its regulators showed up again recently when the overseers rejected a consulting firm MERS proposed to hire in connection with the settlement. The agencies told MERS the firm wasn't qualified for the work, the people said. They didn't name the firm.

[Bryan Hubbard](#), a spokesman for the OCC, which has been supervising how MERS is implementing the terms of the settlement, declined to comment. [Andrew Wilson](#), a Fannie Mae spokesman, declined to comment on MERS.

Beyond [Washington](#), MERS is a target of lawsuits filed by local governments and borrowers. Municipal and county officials accused MERS of cheating them out of filing fees, which was previously a reliable stream of revenue. Other suits have argued it overstepped its authority in foreclosures. MERS has won some victories while other cases remain unresolved. In Pennsylvania, a federal judge has allowed county officials to gather a class-action suit against the firm.

'Overwhelmingly Positive'

As legal challenges mounted, President and Chief Executive Officer R.K. Arnold retired in 2011 to be replaced by Beckmann, the former chairman of CitiMortgage Inc.

"Merscorp Holdings, Inc. has had an overwhelmingly positive litigation record," Beckmann said. "The core team of dedicated lawyers who have been handling these matters is still with the company."

He said that he knows of no mortgages that have been invalidated because of MERS' involvement. The company still operates in every U.S. county, he said, "meeting a need that no one else does."

Even if the company survives its legal challenges, the government could someday pull the rug out from under it.

Corker Bill

The Federal Housing Finance Agency, which oversees Fannie Mae and Freddie Mac, included in a five-year strategy published in 2012 a plan to develop a new electronic registration system. Denise Dunckel, an FHFA spokeswoman, declined to comment on the plan's progress.

In 2011, Senator [Bob Corker](#), a Tennessee Republican, introduced a bill that would have created a new registration system he called "MERS 2" to be regulated by the FHFA. A version of the idea has resurfaced in a bipartisan housing finance bill from Senate Banking Committee Chairman [Tim Johnson](#), a South Dakota Democrat, and Senator [Mike Crapo](#), an Idaho Republican. Their measure calls for studying the establishment of a new national mortgage registry -- though it also left room for the states to handle the job.

"Reforming an archaic legal infrastructure and addressing the mountains of paper that impose burdens on modern mortgage finance is a daunting task, but if ever there was a time to consider such an effort, it is now," Stephanie Heller, deputy general counsel and senior vice president at the [Federal Reserve Bank of New York](#), wrote in a paper last year.

Geoff Walsh, an attorney with the National Consumer Law Center in [Boston](#), said he's not surprised MERS is still laboring under its 2011 settlement.

"They'll probably stay under the order until something comes up to replace them," Walsh said. "Hopefully it'll be a public system."

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