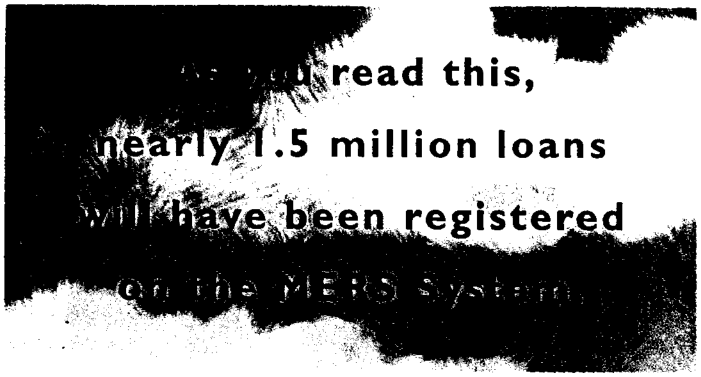
MERS: Tracking Loans Electronically

MERS passed a milestone late last year by getting past the 1 million loan mark on its electronic registry for mortgages. A key change to standard loan documents ushered in the MERS-registered loan as a more accepted part of the origination process. This step sets the stage for industrywide acceptance of this paperless and cheaper alternative to assignments.

BY CARSON MULLEN

THE TERM "BEST EXECUTION" HAS SPECIAL MEANING FOR THE MORTGAGE INDUSTRY. But, in general, it can be defined as the most desirable and valuable way of doing things with the highest degree of skill. Has MERS (Mortgage Electronic Registration Systems) provided the industry with that kind of value? Let's take a look at a little history and at the various lenders and servicers using MERS today.

December 1999 marked a milestone in the brief history of MERS, as the company passed the 1 million mark in mortgage loan registrations on its national electronic loan registry. McLean, Virginia–based MERSCORP, Inc., is the operating company that owns the MERS® System and is the parent of Mortgage Electronic Registration Systems, Inc., McLean, Virginia, which is the company that appears as mortgagee of record in the county land records.



MERSCORP, Inc., was formed by Mortgage Bankers Association of America (MBA) member companies as a central electronic loan registry in an ambitious attempt to help lenders streamline the lending process and eliminate the need to record assignments when selling loans to other mortgage companies.

In 1998, the industry's leadership recapitalized MERS to permit the company to complete what it had begun in its first year of operation. Now is a good time to check the progress of the effort and take a look at the future.

As you read this, nearly 1.5 million loans will have been registered on the MERS System. More than 100 companies use MERS, with registrations occurring every day. Six of the top 10 mortgage originators (according to *Inside Mortgage Finance)* are originating or purchasing MERS-registered loans. Other major originators and aggregators, representing 20 of the nation's top 30 lenders, are integrating MERS into their operations this spring and summer. The participation in MERS by these lenders, plus its acceptance by Fannie Mae, Freddie Mac, Ginnie Mae, Federal Home Loan Bank, VA, FHA and major Wall Street rating agencies, means that all lenders and investors can accept MERS-registered loans.

A little history

The rising tide of paper that was choking mortgage loan productivity in the early 1990s provided the impetus for an industry task force to recommend the establishment of MERS in an effort to eliminate the need to prepare and record assignments. MERS would allow mortgage lenders and servicers to cooperate to reduce or eliminate their paperwork burdens and bring a higher level of efficiency to secondary market sales and trades between trading partners. Because secondary market transactions involving the sale of both beneficial rights as well as servicing rights generated a flood of paper mortgage loan assignments, MERS took up the task of providing an alternative to using paper for tracking these transfers between trading partners.

The Depository Trust Corporation (DTC), New York City, provided a good model. DTC had long ago enabled the national securities markets to eliminate the need for paper stock certificates to record the purchase and sale of stocks, bonds and other securities. DTC is a participant-owned corporation that records securities transactions electronically, eliminating the need to pass paper stock certificates or other security certificates back and forth. It is difficult to imagine accommodating the current volume of securities trading on the national exchanges if stock traders were required to use paper certificates to pass ownership rights.

The MERS System was designed to perform similar functions for mortgage lenders, but with a difference: MERS would first concentrate on eliminating mortgage loan assignments by providing an electronic registry to track the many transfers that occur in our active markets today. Although many lenders are using assignments to make MERS the mortgagee of record, the maximum cost reductions for lenders occur when MERS appears in the security instrument. This concept is known as MERS as Original Mortgagee (MOM).

MERS received approval from Fannie Mae and Freddie Mac in 1997 to act as mortgagee of record on uniform security instruments. This approval meant that MERS could be named in the mortgage or deed of trust as mortgagee and nominee for the lender at the outset. Then once the security instrument was recorded, transfers of beneficial rights and servicing rights could be tracked on the MERS electronic database, eliminating the need for any recorded assignments between trading partners. Approved Fannie Mae/Freddie Mac security instruments became available in late spring 1998 from document vendors.

Systems, the MIN and value

Mortgage lenders can be reluctant to embrace change, especially to their business processes. While naming MERS as mortgagee on the security instrument seems a fairly straightforward change, loan origination systems and servicing systems needed to be modified. Several large mortgage lenders and servicers that could see the immediate benefits of eliminating assignments from their operations began to make the necessary system changes.

The process was slow, but by the end of 1998, several lenders and wholesalers were ready to originate and/or purchase MERS-registered loans from trading partners. The process continued to gain momentum during 1999, in spite of a lengthy systems freeze imposed on most lenders by Year 2000 computer concerns. As companies lifted their Y2K development freezes, MERS activity accelerated.

"Today, many vendors have completed MERS-related enhancements or are in the process. MERS-ready software is rapidly becoming a feature demanded by mortgage companies," says Dan McLaughlin, executive vice president and product division manager for MERS. "In the last year, we have seen MERS readiness become key criteria in our customers' evaluation of new software products. In exhibition halls and in advertising, the 'MERS-Ready' logo is prominently displayed by those vendors that have completed integration testing with us."

Not to be left in the dust in the race for e-commerce solutions, McLaughlin announced at the MERS user conference in March that MERS will introduce a browser-based interface for registering loans on MERS in May. "Market research indicates that our MERS Lite members should gain substantial benefits from registering loans through our Web-enabled interface to MERS," says McLaughlin. "It's one more way that we are making it easier for customers to use

MERS." MERS Lite members are companies that typically originate and sell their production servicing-released.

MERS benefits are available to lenders by using a mortgage identification number (MIN) that can be created by the lender and placed on the mortgage or deed of trust prior to closing. This change affects loan origination and closing document systems. The MIN is used on MERS to track a mortgage loan throughout its life. The MIN must be recognized and tracked by loan origination, secondary market and servicing systems.

The good news for companies embracing system changes was that using MOM, as the practice has come to be known, provides an immediate cost reduction of approximately $22 per loan. The MERS registration fee is $3.50, yielding substantial savings over paper processes. This up-front cost savings has provided a powerful incentive for lenders who deal in secondary market transactions, which is the majority of lenders today.

Mortgage loan servicers also benefit substantially from the elimination of the need to track, account for and correct paper assignments. As servicing rights are traded, transfers are tracked electronically on the MERS database. No assignment is required to effect the transfer between MERS members, nor for sales to Fannie Mae or Freddie Mac, for inclusion in Ginnie Mae securities or for private rated or nonrated securities.

MERS impact on securities

In February 1999, Lehman Brothers took the first step in the securities market by including MERS-registered loans in a jumbo mortgage-backed security (MBS). This security gave the rating agencies the chance they had waited for—an opportunity to rate a MERS package. Standard & Poors, Duff & Phelps and Fitch IBCA have rated securities containing loans that name MERS as mortgagee of record without hurting the security's rating.

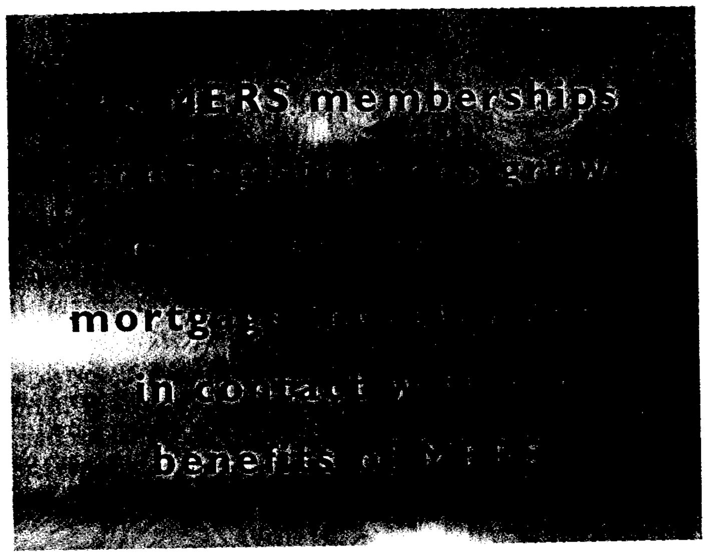
Moody's Investors Service took the opportunity to issue an independent *Structured Finance* special report entitled "Mortgage Electronic Registration Systems, Inc. (MERS): Its Impact on the Credit Quality of First-Mortgage Jumbo MBS Transactions" in April 1999. The report states that the "impact on the credit quality of jumbo first-mortgage MBS transactions will be negligible." The report also identified areas that would not be harmed: the legal mechanism to put creditors on notice of a mortgage is valid; the ability to foreclose and take real estate owned (REO) will not be materially affected; and credit enhancement levels for first-mortgage jumbos will not be increased as a result of the use of MERS. (Any nonstandard could add credit enhancement; MERS does not).

However, the most significant finding in the report specified that in transactions where the securitizer used MERS, there would be no need for new assignments of mortgages to the trustee of MBS transactions.

"We are aware of five major companies that have MERS-registered loans in their securitizations: Lehman Brothers, Bank of America, Norwest, Residential Funding Corporation [RFC] and Countrywide," says Bill Hultman, senior vice president of MERS. "These companies have been the pioneers and cleared the path for MERS as the best execution for all types of mortgage loans."

In pursuing acquisition of MERS-registered loans, RFC indicated that the cost savings would be approximately $15 to $17 a loan. Norwest estimated its savings would be in the neighborhood of $300,000 to $500,000 this year for its correspondent loans (i.e., savings from back-office improvements such as elimination of the need to track, correct and rerecord missing or incorrect assignments).

Rick Scogg, president of Aurora Loan Services, Aurora, Colorado, says his company saves hundreds of thousands of dollars a year. "We have already benefited and will benefit considerably more in the future," he says. "We buy and sell servicing frequently. When we buy portfolios, there are payoffs and foreclosures the next day and therefore there is a delay in the lien-release process [for non-MERS loans]. With



MERS, we don't need to get attorneys to correct these, and that saves us thousands of dollars a year.

"Truly, the foreclosure and release process is the biggest pleasant surprise for us," Scogg says. "It has had a major impact on our efficiency after acquisitions."

Warehouse lenders

As MERS memberships and registrations grow, more sectors of the mortgage industry come in contact with the benefits of MERS. Interim funders can get a security interest in a MERS-registered loan in three ways: they can accept an unrecorded assignment from MERS in recordable form; waive the unrecorded assignment by becoming a MERS member and registering its interest on the MERS System; or waive the unrecorded assignment from MERS and enter into an electronic tracking agreement that establishes a contractual relationship among MERS, the interim funder and the mutual customer.

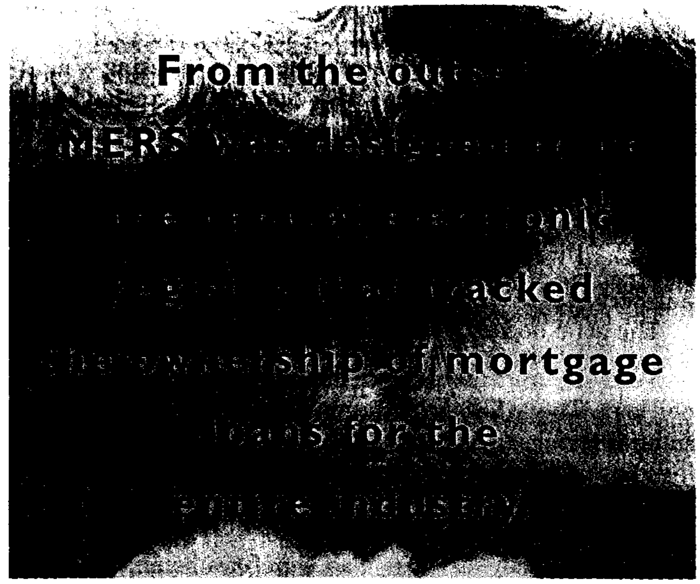
The electronic tracking agreement has emerged as the best and most comfortable solution for these lenders and for MERS and its members. It gives everyone a contract that all parties agree to, which requires MERS, upon notice, to become the nominee for the interim funder in the public land records. That means the security interest of the interim funder is automatically perfected without any further action if there is a default by the MERS member who is also the interim funder's customer.

"We anticipate this will become the method chosen by most interim funders," says Hultman. "Several entities have approved this method and accepted it as a way of doing business without requiring the traditional unrecorded assignment. As more companies adopt this as a way of doing business, it will quickly establish MERS as the best execution in this arena as well."

The lender advantage

From the outset, MERS was designed to be the central electronic registry that tracked the ownership of mortgage loans for the entire industry. The approval of MOM (where MERS serves as nominee for the lender in the recorded security instrument) by Fannie Mae and Freddie Mac allowed the industry to register loans on the system without a prior assignment. Let's look at how registration and tracking of ownership rights on MERS have worked and examine if MERS delivered the cost savings that was projected.

There is no doubt that approval for MERS to act as original mortgagee provided the catalyst for the success of MERS. In the year and a half since MOM loan documents became available, many more companies have activated their membership (some companies had a latent deactivated membership status, while others became members) in MERS. The first two large companies to encourage their correspondents to deliver MERS loans were Norwest Mortgage (now Wells Fargo), Des Moines, Iowa; and Nations Banc (now Bank of America Mortgage), Charlotte, North Carolina. In July 1998, Merrill Lynch Credit Corporation became the first lender to originate MOM loans by using MOM security



instruments. But another national company took its MERS participation one step further.

In 1999, Old Kent Mortgage Company, Grand Rapids, Michigan, became the first nationwide company to implement MERS companywide for correspondent, wholesale and retail origination channels. Old Kent registers loans in two ways: by using MOM and by assigning closed loans—either purchased or in portfolio—to MERS.

After one full year of experience with MERS, Old Kent has realized many benefits. Says Michelle Genrich, vice president of operations for Old Kent, "There is no doubt that the savings identified in the cost benefit [analysis] are now a reality. The registered loans have not gone to final payoff yet, but we expect even greater benefits at that time. The next refi period will be the true test, and we have no doubt the savings will be there also."

Old Kent has benefited from streamlining the origination process through the elimination of the assignments. The $3.50 registration fee is paid by the borrower and is shown on the HUD-1 for conventional loans. "MERS is a win-win [situation]," says Genrich. When lenders originate loans using "MERS as Original Mortgagee (MOM), the need for an assignment is eliminated—creating a cost savings of about $22 per loan. Old Kent has listed the $3.50 charge on the HUD-1 and the borrower has paid the $3.50 instead of paying the $22 for an assignment.

Alliance Mortgage Company, Jacksonville, Florida, has been registering loans on the MERS System for two years, both using MOM documents and by assignment. "The elimination of the assignment has been tremendous for us," says Betty Ellis, vice president of operations for Alliance. "It is not just confined to the monetary savings of not having to record the assignment, but all of the nitty-gritty [steps involved] in many processes that cost time and money.

"For example," Ellis says, "the accounting department has savings directly related to MERS that were not identified in the cost-benefit analysis. If a recording fee check doesn't clear the bank for an extended period of time, it has to be reissued and other departments notified about the stale check. This

The MERS Difference In the Life of a Loan

The following is a brief summation of the pathway taken by a MERS loan:

- Originate and close loan with MOM security instrument and record with county recorder.
- Register the loan data on MERS® System.
- Track transfer of beneficial or servicing rights electronically (no assignment).

The following is the path of a non-MERS loan:

- Create security instrument and assignments for closing, both recorded and unrecorded assignments.
- Record security instrument and loan assignment with county recorder.
- Await return of recorded assignment.
- Correct assignment mistakes.
- Rerecord correct assignments.
- Endure constant follow-up from investors.
- Lose productivity chasing paper.
- Watch assignment costs multiply.

multiplies over a period of time when there are thousands of loans. The back office saves a tremendous amount of time. The savings per loan in this case is a minimum of $20."

McLean, Virginia–based NVR Finance, Inc., has adopted MERS registration to streamline deliveries to its correspondent trading partners. "The initial impact within the company has been great," says Charles L. Riecker, executive vice president of NVR. "For example, in our managers meeting when we announced we would be doing MOM docs, our managers expressed tremendous expectations of greater efficiencies as a result.

"One of the title companies that does a lot of business with us said they would like to insure all of their loans in this fashion. They were overjoyed," Riecker says. "The concept is so simple, but people in general don't grasp the ramifications of MERS. Even in a situation where servicing is retained, some loans require more than one assignment. The changing market creates additional assignments. MERS eliminates all that."

Big benefits for servicers

A number of servicers that have serviced MERS-registered loans are already reaping the benefits of MERS. Large and small servicers benefit from the elimination of assignments in a number of ways. From the beginning of the postclosing process, savings occur because companies do not need to track documents and re-record them if errors occurred. Unrecorded assignments to Fannie Mae and Freddie Mac are unnecessary, and Ginnie Mae certification procedures are streamlined.

HomeSide Lending, Jacksonville, has experienced cost and time savings in postclosing areas not often easily identified. For example, HomeSide saves time by using MERS certifying officers for releases in the paid-in-full department,

LENDERS ON THE MERS SYSTEM SINCE APRIL 1997

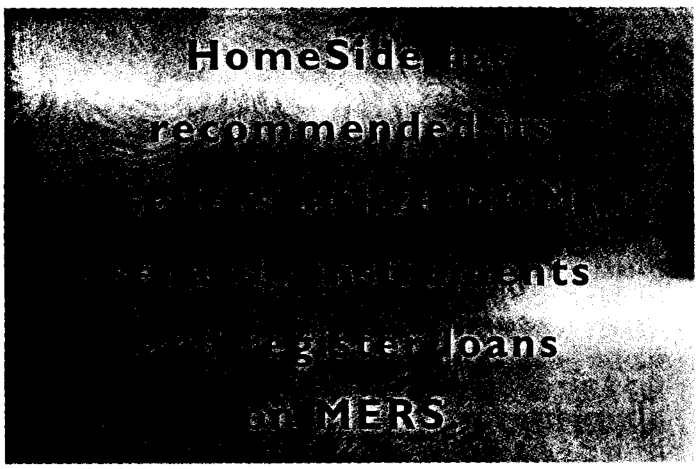
Aegis Mortgage Corporation
Alliance Mortgage Banking Corporation
Alliance Mortgage Company
Amaximis Lending, LP
Ameri-National Mortgage Company, Inc.
America Mortgage Express Financial
American Mortgage Funding Corporation
AmeriSouth Mortgage Company
Aurora Loan Services, Inc.
BancMortgage Financial Corporation
Bank of America Mortgage
Bank of New York Mortgage Company, LLC
Cal Coast Mortgage Corporation
Cendant Mortgage
Centennial Bank
Chase Manhattan Mortgage Corporation
Chevy Chase Bank, FSB
CitiMortgage, Inc. (formerly Source One Mortgage)
Citizens Bank of Cortez
Com Unity Lending
Commerce Mortgage Corporation
ComNet Mortgage Services
Continental Savings Bank
Corinthian Mortgage Corporation
Countrywide Home Loans, Inc.
Crescent Mortgage Services, Inc.
Eagle Home Mortgage, Inc.
Federated Lending Corporation
First Nationwide Home Finance
First Nationwide Mortgage Corporation
Fortress Mortgage, Inc.
GN Mortgage Corporation
Guaranty Bank, SSB
Harbor Financial Mortgage Corporation
Home Financing Unlimited, Inc.
HomeSide Lending, Inc.
Horizon National Bank
Household Financial Services
Ivanhoe Financial, Inc.
Ivy Mortgage
Landmark Financial Services
Majestic Mortgage Services, Inc.
Market Street Mortgage Corporation
McAfee Mortgage & Investment Company, Inc.
Merrill Lynch Credit Corporation
Mid America Mortgage, Inc.
Midwest Mortgage Services
Molton, Allen & Williams Corporation
Molton, Allen & Williams, LLC
Mortgage Investment Corporation
Mortgage South, Inc.
Nationwide Home Mortgage Company
Nextstar Financial Corporation
North American Mortgage Company
Norwest Mortgage, Inc. (now Wells Fargo)
Old Kent Mortgage Company
PNC Mortgage Corporation of America
Principal Residential Mortgage, Inc.
ReliaStar Mortgage Corporation
Residential Mortgage Corporation
Select Mortgage
Shea Mortgage
Shore Mortgage
Sound Mortgage, Inc.
Sterling Capital Mortgage
Temple-Inland Mortgage Corporation
Unity Mortgage Corporation
Visalia Mortgage Corporation
Voyager Bank/Voyager Mortgage
W/E Mortgage, Inc.
WestAmerica Mortgage Company
Western States Mortgage Corporation

where completion of releases can be done in half the time, according to Stephan Avery, project manager at HomeSide.

HomeSide is implementing MERS in phases. The company eliminated assignments by using MERS to register bulk loans and co-issue transactions. Eliminating as much as 300,000 agency assignments had a significant economic impact.

Says Avery, "Some trading partners were initially hesitant about registering loans on MERS. But we found that as we walked them through the process, they realized MERS was not a mammoth project requiring tons of resources to implement."

William Glasgow, executive vice president of HomeSide, has been instrumental in incorporating MERS into company operations. "We expect MERS to provide a long-term benefit to HomeSide's servicing and production divisions by simplifying the document tracking and recovery



process," he says. "Furthermore, we expect our wholesale production customers to benefit by reducing the expense of originating mortgages. The economic benefit will be derived over the expected life of the book of business currently registered. The immediate savings for HomeSide comes from certain bulk transactions completed."

HomeSide has recommended its sellers utilize MOM security instruments and register loans on MERS.

Anthony P. Meli, senior vice president of Edison, New Jersey–based Chase Manhattan Mortgage, says, "MERS has enabled us to reduce costs for our business partners by eliminating the assignments. These are hard dollar savings for our clients and [that] is another reason for them to do business with Chase."

Chase correspondents have been delivering MERS-registered loans at an increasing rate, according to Meli. "Tracking assignments back and forth with county recorders' offices and just handling the paper is extremely expensive," says Meli. "These costs are embedded in the process, and eliminating assignments cuts these costs for us.

"We recommend MERS to our trading partners," Meli says, "because MERS-registered loans streamline the process, and we don't have to handle the paper either. The future for our industry relies on creating more efficiencies in the process, reducing costs and managing data, not paper. We encourage our business partners to take advantage of this methodology now."

Fleet Mortgage Group, Columbia, South Carolina, offers the perspective of a company preparing to integrate MERS into its business operations this year. "Fleet correspondent lending is and has been a huge proponent of MERS," says Stannye Baringer, senior vice president of correspondent lending operations for Fleet. "We believe that this is where the industry wants to be, as it clearly benefits all parties in the transaction. Many of our customers have approached us about MERS, and as more and more aggregators and servicers come on board with MERS, it will make it easier and less costly for correspondents to do business."

"A number of our customers are already MERS-enabled," Baringer says. "Because of the size of our servicing portfolio, we must have the process automated. At the same time that enhancements are being made to our servicing system to accommodate MERS, we are implementing a new front-end system. So it has taken us just a bit longer to roll out MERS to our customers. But we will be there, too."

In February, Principal Residential Mortgage, Des Moines, Iowa, announced its delivery program to correspondents. "Over the past year, our correspondents have been asking us to get involved with MERS," says Phil Kuhn, vice president of correspondent lending for Principal. "Our correspondents view us as having a full spectrum of products because we are able to accept MERS loans."

Kuhn cites the example of a recent discussion with a prospective correspondent. "This correspondent decided to come aboard with Principal because we are now MERS-ready. Correspondents view MERS as a future trend," he says. "We're absolutely recommending MERS to all our trading partners."

Service providers assist

One of the ways to measure best execution is to assess the impact of a process in business flows. Says Jim Stewart, vice president of new accounts for Glendale, California–based Nationwide Title Clearing, "Over the past two years or so, and especially last year, we at NTC have seen a marked increase in our clients' desire to record assignments to MERS. And I can't think of a single instance in which a client has wanted to 'deregister' a loan off of MERS."

Mary E. (Bette) Albarran, managing director of Bay View Financial Trading Group, Beltsville, Maryland, has worked with several customers who are MERS members. "As more companies become active on MERS, we will see trading of registered MERS loans really become advantageous for sellers, especially for agency paper," she says. "It all comes down to what the seller will net out of the gross purchase price. Preparation and recording of assignments erode that price. When both parties are on MERS, the costs are considerably reduced.

"All things being equal, if a seller is on MERS, they prefer to sell to a purchaser who is on MERS rather than to a non-MERS purchaser for whom they would have to produce assignments," says Albarran. "MERS-ready sellers can avoid the whole issue of assignments by performing transfers electronically to a MERS purchaser. Not only is cost a factor, but preparing, recording and tracking assignments is extremely time consuming.

"Obviously, purchasers pick and choose the portfolio offerings they will bid on based on a number of criteria," Albarran continues. "A purchaser will consider the size of the offering, the investor, the types of loans, WAC [weighted average coupon], WAM [weighted average maturity] and geographic location. It would certainly be an advantage for a MERS purchaser to find a seller who can provide MERS-registered product. An added advantage is the reduction in time to recertify pools."

Albarran also works with Bayview Portfolio Services, a MERS registrar. She believes that most companies that buy and sell loan servicing as a regular part of their business plan will use MOM. "At some point in time," says Albarran, "we will have to assume that most of these companies will become MERS members. It only makes sense."

R.K. Arnold, president and chief executive officer of MERS, has led the effort to encourage lenders and servicers to adopt MOM loans as their standard business methodology. "It's been gratifying to watch the trend of more and more companies embracing the MERS assignment-free method of doing business," he says. "The year 1999 validated the MERS concept with lenders large and small. It's now our job to accelerate the pace of industry acceptance in the year 2000."

As thousands of new MERS-registered loans are boarded by servicers, the elimination of assignments from the business process has shown collateral benefits, even outside the typical residential mortgage transaction. "Our members have found numerous new ways that using MOM documents adds to efficiencies in their shops," says Arnold.

"We've also been approached by nontraditional lenders and commercial lenders to eliminate assignments from their processes as well," Arnold says. "In fact, in some respects the commercial lending sector is an even richer ground for MERS, because so many commercial deals require multiple assignments. We already have some commercial lenders that have decided to use MERS, and the timeshare sector seems to be particularly interested.

"Several electronic exchanges have approached us to do business as well. They see MERS as the only way to offer a fully electronic mortgage transaction; otherwise, assignments are required to sell the loans," says Arnold.

"Finally, second mortgages and home-equity loans represent some of our best volume—and subprime lenders, with all those multiple assignments, see extra benefits to MERS originations," Arnold says. "These business sectors will add to the overall savings that MERS can bring to the mortgage industry, making a MOM loan the best execution." **MB**

Carson Mullen is executive vice president and customer division manager for MERS, McLean, Virginia. He was formerly president and chief executive officer for Wasatch Document Systems, Salt Lake City, and vice president of national accounts for MGIC, Milwaukee.