IN THE SUPREME COURT OF FLORIDA

CASE NO.: 09-1460

IN RE: AMENDMENTS TO RULES OF CIVIL PROCEDURE AND FORMS FOR USE WITH RULES OF CIVIL PROCEDURE

COMMENTS OF THE FLORIDA BANKERS ASSOCIATION

The Florida Bankers Association thanks this Honorable Court for the opportunity to comment on the Emergency Rule and Form Proposals of the Supreme Court Task Force on Residential Mortgage Foreclosure Cases.

Introduction:

The Florida Bankers Association ("FBA") is one of Florida's oldest trade association. Its membership is composed of more than 300 banks and financial institutions ranging in size from small community banks and thrifts, to medium sized banks operating in several parts of the state, to large regional financial institutions headquartered in Florida or outside the state. The FBA serves its constituents and the citizens of the state of Florida by serving as an industry resource to all branches and levels of government in addressing those issues which affect the delivery of financial services within this state.

SUMMARY OF THE COMMENTS

The Supreme Court Task Force on Residential Mortgage Foreclosure Cases ("Task Force") proposes an amendment to Florida Rule of Civil Procedure 1.110 to require verification of residential mortgage foreclosure complaints. The proposed rule does not effectuate its stated goal of deterring plaintiffs that are not entitled to enforce the underlying obligation from bringing foreclosure actions. Existing and effective law provides better substantive protection against unauthorized foreclosure suits. Section 673.3091, Florida Statutes, establishes stringent proof standards when the original note is not available, and requires the court to protect the mortgagor against additional foreclosure actions. In addition, the courts have ample authority to sanction lawyers and lenders asserting improper foreclosure claims. This authority is explicit in Florida law and implicit in the courts' inherent power to sanction bad faith litigation. Finally, the proposed amendment imposes a substantive condition precedent to foreclosing a residential mortgage foreclosures and thus appears to violate Florida's constitutional doctrine of separation of powers.

COMMENTS

I. THE PROPOSED AMENDMENT WILL NOT EFFECTUATE THE DESIRED GOAL.

The rationale for the proposed amendment is set forth in the proposal for promulgation:

> This rule change is recommended because of the new economic reality dealing with mortgage foreclosure cases in an era of securitization. Frequently, the note has been transferred on multiple occasions prior to the default and filing of the foreclosure. Plaintiff's status as owner and holder of the note at the time of filing has become a significant issue in these case, particularly because many firms file lost note counts as a standard alternative pleading in the complaint. There have been situations where two different plaintiffs have filed suit on the same note at the same time. Requiring the plaintiff to verify its ownership of the note at the time of filing provides incentive to review and ensures that the filing is accurate, ensures that investigation has been made and that the plaintiff is the owner and holder of the note. This requirement will reduce confusion and give the trial judges the authority to sanction those who file without assuring themselves of their authority to do so.

With respect and appreciation for the efforts of the Task Force and its laudable goals, the proposed amendment will not effectuate the reduction of confusion or give trial judges any authority they currently lack.

A. Plaintiff's Status as Owner and Holder of the Note.

In actual practice, confusion over who owns and holds the note stems less from the fact that the note may have been transferred multiple times than it does from the **form** in which the note is transferred. It is a reality of commerce that virtually all paper documents related to a note and mortgage are converted to electronic files almost immediately after the loan is closed. Individual loans, as electronic data, are compiled into portfolios which are transferred to the secondary market, frequently as mortgage-backed securities. The records of ownership and payment are maintained by a servicing agent in an electronic database.

The reason "many firms file lost note counts as a standard alternative pleading in the complaint" is because the physical document was deliberately eliminated to avoid confusion immediately upon its conversion to an electronic file. *See State Street Bank and Trust Company v. Lord*, 851 So. 2d 790 (Fla. 4th DCA 2003). Electronic storage is almost universally acknowledged as safer, more efficient and less expensive than maintaining the originals in hard copy, which bears the concomitant costs of physical indexing, archiving and maintaining security. It is a standard in the industry and becoming the benchmark of modern efficiency across the spectrum of commerce—including the court system.

The information reviewed to verify the plaintiff's authority to commence the mortgage foreclosure action will be drawn from the same database that includes the electronic document and the record of the event of default. The verification, made "to the best of [the signing record custodian's] knowledge and belief" will not resolve the need to establish the lost document.

B. The Process for Re-Establishing the Note Provides Significant Substantive Protection to the Mortgagor.

The process for re-establishment of a lost or destroyed instrument by law imposes a strict burden of proof and instructs the court to protect the obligor from multiple suits on the same instrument. Section 673.3091, Florida Statutes, sets forth the elements a plaintiff must prove in order to enforce an obligation for which it does not have the original instrument:

> A person not in possession of an instrument is entitled to enforce the instrument if:
>
> a) person seeking to enforce the instrument was entitled to enforce the instrument when loss of possession occurred, or has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when loss of possession occurred.
>
> b) The loss of possession was not the result of a transfer by the person or a lawful seizure; and
>
> c) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

Once the plaintiff has plead **and proved** the foregoing, there is an additional judicial requirement:

> **The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.**

§ 673.3091(2), Fla. Stat. (emphasis added).[1] This protection may be effectuated by any means satisfactory to the court. It commonly takes the form of a provision in the final judgment stating that to the extent any obligation of the note is later deemed not to have been extinguished by merger into the final judgment, the plaintiff has by law accepted assignment of those obligations. In other words, the

[1]The legislature amended Section 673.3091, Florida Statutes, in 2004 to address the issues raised by the *State Street* court in recognition of the commercial reality that almost all purchase money notes are electronically stored and assigned in electronic form.

plaintiff who enforces a lost or destroyed instrument assumes the risk that a third party in lawful possession of the original note or with a superior interest therein will assert that claim. The original obligor has no liability.

C. Courts Have Statutory and Inherent Authority to Sanction Plaintiffs Asserting Claims Not Supported by Law or Evidence.

Any party seeking to foreclose a mortgage without a good faith belief—based on investigation reasonable under the circumstances--in the facts giving rise to the asserted claim may be sanctioned "upon the court's initiative." § 57.105(1), Fla. Stat. This statute, though somewhat underused by our courts, affords judges the authority to immediately impose significant penalties for bringing unfounded litigation. Perhaps more significant is this Court's recent (and appropriate) reaffirmation of a trial court's inherent authority to sanction litigants—specifically attorneys—who engage in bad faith and abusive practice. *See Moakely v. Smallwood*, 826 So. 2d 221, 223 (Fla. 2002), citing *United States Savings Bank v. Pittman*, 80 Fla. 423, 86 So. 567, 572 (1920) (sanctioning attorney for acting in bad faith in a mortgage foreclosure sale).[2]

[2] The potential for sanctions is **in addition** to the significant economic deterrence to bringing unauthorized foreclosure actions. Presuit costs such as title searches and identification of tenants and/or subordinate lienors, the escalating filing fees and costs of service (particularly publication service and the concomitant cost of diligent search if the mortgagor no longer resides in the collateral) significantly raise the cost of filing a suit in error.

II. REQUIRING VERIFICATION OF RESIDENTIAL MORTGAGE FORECLOSURE COMPLAINTS IMPLEMENTS PUBLIC POLICY WITHIN THE LEGISLATURE'S CONSTITUTIONAL AUTHORITY.

The Task Force Report giving rise to the proposed amendment clearly speaks to a public policy concern unrelated to the procedural concerns of the courts. The stated purpose—to prevent the filing of multiple suits on the same note—is clearly a matter of public policy rather than one of court procedure. Requiring verification of a residential mortgage foreclosure complaint imposes a condition precedent to access to courts that exceeds the procedural scope of the Florida Rule of Civil Procedure 1.110. In situations in which verification of complaints or petitions is established as a threshold requirement for pursuing an action, that requirement is imposed by the legislature. *See*, *e.g.*, § 702.10, Fla. Stat. (requiring verification of mortgage foreclosure complaint where plaintiff elects Order to Show Cause procedure.) If public policy favors setting an evidentiary threshold for access to courts, the legislature must exercise its policy-making authority.

The only other rule of civil procedure which imposes the duty to verify a petition is a petition for temporary injunction. Fla. R. Civ. P. 1.610. The rationale for requiring verification there is clear: The petition itself and any supporting affidavits constitute the evidence supporting the requested temporary injunction. The court's decision is made solely on the evidentiary quality of the documents

before it. That is not the case here. Verification of the foreclosure complaint will not relieve the plaintiff seeking to foreclose a residential mortgage of the burden of proving by competent and substantial evidence that it is the holder of the note secured by the mortgage and entitled to enforce the mortgagor's obligation.

Verification adds little protection for the mortgagor and, realistically, will not significantly diminish the burden on the courts. The amendment is not needed or helpful.

CONCLUSION

The Florida Bankers Association recognized the hard work and the laudable goals of the Supreme Court Task Force on Residential Mortgage Foreclosure Cases. However, it appears that in the urge to find new ways to address the crisis facing mortgagors **and mortgagees** as well as the court system, the Task Force fashioned a new and ineffectual rule while ignoring the panoply of significant and substantive weapons already provided by Florida law. The Florida Bankers Association respectfully requests that this Honorable Court decline to adopt the proposed amendment to Florida Rule of Civil Procedure 1.110.

Respectfully submitted,

Florida Bankers Association

Alejandro M. Sanchez
President and CEO
Florida Bankers Association
1001 Thomasville Road, Suite 201
Suite 201
Tallahassee, FL 32303
Phone: (850) 224-2265
Fax: (850) 224-2423
asanchez@floridabankers.com

Virginia B. Townes, Esquire
Florida Bar No.: 361879
AKERMAN, SENTERFITT
420 South Orange Avenue
Suite 1200 (32801)
Post Office Box 231
Orlando, FL 32802
Phone: (407) 423-4000
Fax: (407) 843-6610

virginia.townes@akerman.com

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing comments have been served on The Honorable Jennifer D. Bailey, Task Force Chair, 73 W. Flagler Street, Suite 1307, Miami, Florida 33130-4764, this 28th day of September, 2009.

Virginia Townes, Esquire
Florida Bar No. 361879

* *

MEETING OF THE

TASK FORCE ON JUDICIAL FORECLOSURE RULES

November 7, 2007

* *

Taken before D'Lois L. Jones, Certified Shorthand Reporter in and for the State of Texas, reported by machine shorthand method, on the 7th day of November, 2007, between the hours of 9:36 a.m. and 11:46 a.m., at the Winstead, Sechrest & Minick, 401 Congress, Suite 2400, Austin, Texas 78701.

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MR. BAGGETT: Okay. Why don't we get started? We have lunch. I have no clue whether we're going to get there or not, and if we don't get there, I don't care. If we get there, fine. It doesn't make any difference. We'll do what we need to be doing. I first of all want to thank all of you for giving of your time and talent. We want both, and the billable hours and the money you get out of this are zero, so don't worry about that. That's not a good start, but we're doing, I think, good things.

I will tell you that my view of what lawyers have to do to make the world work better for everybody and what I hope this task force does is get deals done and solve problems. If we'll all bear in mind that's what we need to be doing, we'll do just fine, and we had this task force, some of you were in here in '97 and '99, and when we got started we said we're going to do this together for the benefit of the State of Texas. There's no winners or losers, whatever position you come in here, just contribute so we can all make an educated decision on what's the best for Texas. The only winners or losers are this group if we all win together, so we're not going to come in here and argue points and all that.

We're going to figure out how we make it

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work for everybody, and I don't know whether this is totally true, but I said it several times and nobody has disagreed, so I'm going to keep on saying it. In '97 and '99 when we got through with the rules and the task force, we all agreed unanimously on it, and we all got along great, and we had a good time doing it, went to the Supreme Court and they approved it unanimously, and a couple of the judges said, "This never happens like this," and I said, "Well, good. I'm glad we're going to do that." So we're all going to be winners because we're going to do that again. We're going to come out where everybody agrees, and we're going to take it over there and they're going to all agree. So that's our goal in life. If we do that, we will all win. So that's kind of where we are and what we're going to do.

I think what we're probably going to do this morning is go around the room. We want each of you to say who you are, where you're from, and what you bring to the table in terms of expertise and experience, and we've got -- we tried to when putting this committee together to get all sides of most of the issues so we can know what all the issues are and deal with them fairly. That is what we tried hard to do, and we'll see how successful we are at the end of it, but we tried to do that.

And then probably we'll go around after

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that, open it up if people have particular issues, and we'll probably go around again and let you say what they are, what you think about it, and what we need to be doing, and then we'll go from there. Probably after the meeting, we'll probably appoint some subcommittees that will be -- after we see what's happening and so forth, subcommittees that will deal with particular issues to work between when we do and then report back and see if we can't do it that way. Last time Tommy got to do a lot of drafting. This time Tommy is going to get to do a lot of drafting because he did a good job last time, and he did not get fired, and nobody fussed at him.

MR. BARRETT: Well, now wait a minute.

MR. BAGGETT: So that's how --

MR. BASTIAN: I still carry scars.

MR. BAGGETT: Oh, now, Tommy, give these people the right impression, not the wrong impression.

MR. TEMPLE: Mike, I think it's more accurate to say last time he did all the drafting and the rest of us did the second-guessing.

MR. BAGGETT: I think that is probably accurate, so I probably didn't give him due credit. Tommy is the one that came up with the idea, and in the materials you've got what he did to put this together, and the Court agreed, so that's how we got here. Why don't we

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just start going around here, who you are, where you're from, and what you bring to the table.

HONORABLE PHIL JOHNSON: I'm Phil Johnson, and I'm the Supreme Court liaison to the committee. I'm --

MR. BAGGETT: Hold on, we've got some new folks coming. Are you-all on the committee? Okay. You should have nametags somewhere.

MS. HOBBS: Right there.

MR. BAGGETT: Just get one and get a seat. I know Manny.

MR. NEWBURGER: Sorry about that. I flew in late last night.

MR. BAGGETT: I'm sorry. You-all missed a great introduction, but you better ask them if it was any good or not. So we're just getting started, going around the room, who you are and kind of what your experience is in these areas and then we'll open it up for issues later on. Judge, I apologize.

HONORABLE PHIL JOHNSON: That's all right. I've been on the Court a couple of years. I was on the Court of Appeals in Amarillo before that, and before that I tried lawsuits, and all I looked forward to was someone messing up the foreclosure, so I'm here to bring the Court's imprimatur to this and to encourage everybody.

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MR. BAGGETT: Thank you for participating. Lisa.

MS. HOBBS: My name is Lisa Hobbs. I'm the general counsel for the Supreme Court, and I'm here to be of staff assistance as I can be. I have no expertise in this area, and Jody Hughes is our rules attorney, and he will probably have a hand in this as well, but he is on his honeymoon right now, so he couldn't make this meeting, but you will probably be working with him as well.

MR. McRAE: I'm Tock McRae. I'm from San Antonio. I am in-house with C. H. Guenther & Son, which is a privately held food manufacturer in San Antonio, and, no, we don't do any foreclosures there, but in my former life -- I've only been in-house about four years. In my former life I was a banking lending lawyer and was pretty involved in foreclosures, depending on the economic cycles.

MR. BAGGETT: Okay.

MR. REDDING: I'm Tim Redding. I'm with First American in Houston. I was in the mortgage business before I got in the title business, and I've been in the title business 30 years, so that tells you something. I was in the mortgage business going to law school in Houston, and obviously I'm involved in foreclosures being in the title business.

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MS. HOBBS: Hi, Judge Davidson, I'm sorry, I was interrupting someone here, but we have you on the line and we're doing introductions right now.

HONORABLE MARK DAVIDSON: I apologize I was late.

MR. BAGGETT: No problem. Thank you, Judge. And I should have said something that I forgot to say in my elaborate opening remarks, and that is that one of the things that we do need to be careful here is we've got about 200 years of title law, so whatever we do, we probably don't need to mess it up. So we do need to think about titles and how we deal with those, and one of the things I guess about titles is certainty probably helps the title business. Would you agree with that?

MR. REDDING: I'm sorry?

MR. BAGGETT: Certainty.

MR. REDDING: Certainty, absolutely. I mean, that's our biggest problem with fighting bills every session that try to hide information, be it from public officials or things like that. We're always, you know, looking for the information.

MR. BAGGETT: And since foreclosures are a part of the title we need to be careful about that, so anyway.

MR. FUCHS: Fred Fuchs with Texas Rio

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Grande Legal Aid. We represent the homeowners who are facing foreclosures in these kind of suits, and so I'll bring that perspective to the table I hope.

MR. BAGGETT: Fred was on the committee before, and what did I lie about in the opening, Fred? Was it okay?

MR. FUCHS: I thought you were right on.

MS. RODGERS: I'm Kelly Rodgers. I'm an attorney and a lobbyist here in Austin, and I worked on Senate Bill 1520 and the companion regulatory bill during the last session representing the interest of mortgage lenders.

MR. TEMPLE: I'm Larry Temple. I'm an Austin lawyer, and I have for more than 35 years represented the Texas Mortgage Bankers Association, the association of mortgage companies in the state, and they obviously have an interest in this.

MR. CULBRETH: Ken Culbreth. I'm not on the force. I'm just kind of here auditing, was involved with the legislation before, and my client had hired Kelly Rodgers to help us with this, and represent mortgage lenders and taxpayers and seen a lot of this in the courts and the litigation and just continue to be interested.

MR. BAGGETT: Okay. Manny.

MR. NEWBURGER: I'm Manny Newburger with

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Barron, Newburger, Sinsley & Weir here in Austin. In my former life I represented consumers suing banks and mortgage servicers and such. These days I represent a large portion of the collection industry. I represent lawyers, debt buyers. My law firm represents I think four trade groups that deal with the collection industry, and I still teach consumer law at UT and periodically still advocate for consumers.

HONORABLE BRUCE PRIDDY: My name is Bruce Priddy, and I'm a district judge in Dallas in the 116th. I've only been on the bench for about ten months now. I've heard about -- probably about a hundred 736 applications in the short time I've been there and have a strong interest in this area of the law. Before I was elected to the bench I was a consumer lawyer and had some experience in home equity litigation, representing consumers exclusively, mostly pro bono, some intentional, some nonintentional, but home equity lending is something that interests me a great deal.

MR. BAGGETT: Okay. Thank you.

MS. DOGGETT: I'm Mary Doggett. I'm an attorney in San Antonio. I represent the Texas Property Tax Lenders Association and several companies that do property tax lending. My background is that I worked for eleven years with Linebarger, Goggan, Blair & Sampson

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collecting delinquent taxes for various taxing units in Bexar County.

MR. BAGGETT: Okay.

HON. AMALIA RODRIGUEZ-MENDOZA: Good morning. I'm Amalia Rodriguez-Mendoza. I'm the district clerk here in Travis County, and I guess the reason I'm on this committee is to sort of give you the clerk's perspective, but in Travis County on February 28th Judge Dietz signed an order mandating that certain cases be e-filed, and one of the type of cases that is e-filed is home equity and foreclosures, and we receive a lot of e-filing foreclosures, and I don't know if you're doing that e-filing, but I guess that's one of the perspectives that I bring.

MR. BAGGETT: It is. It is. It's a very important perspective, so speak up and let us know what we're doing good and bad because that's important. We need to make sure we do that right. Okay. Thank you. All right, Linda.

MS. KELLUM: I'm Linda Kellum. I'm the court coordinator for the 88th Judicial District Court, which is composed of Hardin and Tyler County. I'm also a certified legal assistant. I've been in the legal profession for probably about 28 years now. I just went off of the board of directors for the Texas Association of

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Court Administration. I also am a faculty member for the Texas Center of the Judiciary with their PDP program, and like Mr. Redding there, I have spent some time in a -- in the title business before as well. My perspective, I suppose, is going to be how the courts deal with it.

MR. BAGGETT: You have a very important perspective, what are we doing good and what are we doing bad from the real life everyday stuff, and that's very important. So both of you, if we get off into esoteric stuff and we're not paying attention to reality, you let us know. Karen.

MS. NEELEY: Karen Neeley. I'm general counsel for Independent Bankers Association of Texas and of counsel with Cox Smith Matthews, and I followed and worked on this 1520 companion regulatory bills as it was going through session.

MR. BARRETT: Hi, I'm Mike Barrett. I'm chairman at Barrett Burke Wilson Castle Daffin & Frappier. I'm Manny's client and Tommy's boss, so I'm just here to make sure they're doing a good job.

MR. BAGGETT: Tommy says he's the boss. All right, Tommy.

MR. BASTIAN: I'm Tommy Bastian, and I'm the peon at Barrett Burke Wilson Castle Daffin & Frappier.

MR. BAGGETT: Okay. Now that everybody

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knows who everybody is, and we have done all that -- yes.

MR. REDDING: On the phone.

MR. BAGGETT: Oh, Judge? Judge?

HONORABLE MARK DAVIDSON: Yeah, I'm here.

MR. BAGGETT: Okay.

HONORABLE MARK DAVIDSON: My name is Mark Davidson. I'm judge of the 11th District Court in Houston. I'm also the administrative judge in Harris County. I have been a judge for 18 years, and I have been doing these since the rule and the constitutional amendment went into effect a long time ago.

MR. BAGGETT: Okay. Well, thank you very much, and we clearly need the skills of the administrative judge in Harris County. And whatever you see that's reality we need to know for sure, because we've got to deal with it at every level, so thank you very much for joining us, and what we'll probably do now is we have two major areas that we probably need to think about and deal with. One is the tax lien information and the other is what's working and isn't working in those two rules that we need to deal with, 735 and 736.

I will say this, that when we had the task force before and we didn't have a rule, we started from scratch, and a little bit of the history -- and I stand for rebuttal from any of you who are in here if you think

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I slipped in what I say here, that's fine, because we have several that have been on all the task forces, and but what we were assigned to do because we got home equity for the first time in a constitutional amendment that said there has to be an order from a court in order to go forward with a foreclosure. So these two rules were to try to address that requirement that there be an order from the court in this area of foreclosures, and first in I guess '97 was home equity, and we talked about where do we go and what do we do, and we were starting from scratch.

And I will say this, although it wasn't popular to say this in the meeting, we borrowed from Colorado, because Colorado had a process somewhat like what we ended up with, and the big concerns were if there's a lot of this we don't want to clog up all the dockets and make the administrative part of it very difficult and if, in fact, they are uncontested, proceed with it on a basis that the rule deals with, but if anybody wants to contest it in any way, they can bring another lawsuit, what I would call a full regular lawsuit in another court, file a notice of it where the application is filed, and it's automatically dismissed without prejudice, and you flip over to full litigation, and that was our thought process about how we do it.

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So it's a balance between full litigation if and when you need it, and if it's not disputed, so we don't clog up the courts and so forth, go forward with this process that we came up with in 735 and 736, and I think it's different than what we've had before, so administratively it caused some problems. Judges weren't familiar with it, which is very understandable, because it was different than anything we've ever done, but I think everybody tried and it worked out pretty well, and then when we got reverse mortgages two years later we just added reverse mortgages to those two rules, and now I guess the thing that probably triggers this more than anything else is we've got the tax lien issues that say you've got to comply with 736.

So we -- again, we need to put into these two rules how we deal with the tax lien situation. That probably is the starting point for most of this, because we've got to deal with that issue. Now, while we're at it, if there are other issues that have arisen, as much from the administrative judge and the coordinators and the clerks, mechanically on how we can improve it or if there are problems with it then we would like to hear any of that if we can.

I will say our goal in life is not to reinvent the Constitution. No, no, no. We need to deal

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with things as efficiently and as precisely as possible. We are not the Supreme Court. We are not the Legislature, and we all haven't been voted into office, so our task, we need to bear in mind, we are not kings and queens, we're just folks trying to figure out how to make this work and do it in an efficient, easy way as opposed to rewriting the Constitution. We don't need to do that, I don't think. So I'm not sure that little talk helped you very much, but that's where we are.

Why don't we talk first, because our primary goal is to deal with how we adapt this rule to tax liens, and I will also say this: This morning throw out everything that anybody has an issue with and we ought to talk about it as much as you want to. What we'll probably do after this, after we see what the different issues are and so forth, we'll probably get some subcommittees that will work between these meetings to come up with some proposed drafts. As Larry said, we did that to Tommy, and he did the work, and we came in and said, "Tommy did a pretty good job, that's good." So maybe that will happen again. That will be fine with me if we do that.

But we'll probably do that, so y'all will probably be hearing after this sometime that you might be on a committee and what we would be looking at. But what we say today as far as issues and how we approach it will

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impact what committees we have and who's on them. Having said that, Tommy, do you want to talk about tax liens and Karen and I guess Kelly? Yeah, go ahead.

MR. TEMPLE: Can I suggest something?

MR. BAGGETT: Sure.

MR. TEMPLE: I don't want to trump what you just said, but it would be instructive to me if before we got into what additions we are going to make if the people that are dealing with this on a regular basis could tell me what problems there are with the present rule to which it's applicable anyway.

MR. BAGGETT: Sure.

MR. TEMPLE: I know there is an issue about lines of credit and there is an issue about reverse mortgages and certainly going to be an issue about the property tax liens, and we'll need to make some additions or changes probably, but without regard to that just a minute, what it was intended to work for, I would be interested in knowing are there issues, are there problems in the way it has been working over the last decade in the areas to which it was originally applicable.

MR. BAGGETT: I was going to go to that next, but that's fine. Let's start on that now. I don't have any problem with that. That's fine. So why don't we do that? Anybody that's dealing with it everyday or has

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issues with it or things that we can improve on the rules and how they work right now, you know, the floor is open and don't hold back, because we need it.

HONORABLE MARK DAVIDSON: Okay. Well, not one to hold back, can I get my first little shot?

MR. BAGGETT: You bet.

HONORABLE MARK DAVIDSON: There appears to be a dispute between attorneys that represent the lenders and some -- no, and most, but not all, judges as to whether or not the papers that are filed with the Court that establish the existence of the debt and the lien must show that the movant, that is the current holder and owner of the note, is the party entitled to foreclose. In other words, whether you have to attach the assignment documents. If I get an application that shows a note paid to the ABC Lending Company and it's the XYZ Bank Company that is seeking to foreclose, some judges say that the motion should be denied, the application should be denied, because the -- unless the assignment from ABC to XYZ is contained in the file.

Other judges maintain that as long as it is pled under oath that the applicant is the holder and owner of the note, that the purpose and effect of the statute has been complied with.

MR. BAGGETT: Gotcha. That is a good start,

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because that's an issue we have around the state with different judges, and I think we ought to do it. Let me tell you what I think about it generally, then I want to go to Tommy who does it more. But I need to tell you, too, we do commercial litigation when it's probably big issues and big problems. We do not do volume foreclosures and so forth, so to the extent that people deal with it on a daily basis, that's not me, so you need to know that, so I'm giving you a disclaimer before I start.

But I think what the issue is that I've heard some is who's the owner and holder and how do you establish that and you have to establish that in order to proceed with the process. This is not -- this is just some general comments. When you have a debt you have several sources of repayment, and I'm going beyond the rules here. This is more of my foreclosure general stuff than it is the rules. You could have a source of repayment for -- from the maker of the note, or it could be nonrecourse. You could have a source or a payment from real property collateral, you could have a source or payment from personal property collateral, you could have guarantors.

So owner and holder of the note, the lien goes with the debt, no question about that, but does not necessarily mean who had -- what's the primary source of

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repayment. So, basically, owner and holder deals with the UCC provisions that have to do with enforcing a note. They don't necessarily deal with real estate foreclosures, personal property foreclosures. There are other sources of repayment on an obligation. So there is a -- I think that's an issue in Florida and some other places, so we've got to pay attention to the -- how this affects the overall body of foreclosure law, but we've got to also be realistic.

The original, I think, intent of those rules was that you file an application, you have to swear to that there is a debt and that it's in default. Nothing else is required to be certified, and it's really there for a situation where you have an uncontested issues to a great extent. If there's ever an issue about who's the owner and holder or anything like that, a lawsuit, I think we contemplated, could be filed in district court, notice of that filed in the application, and the application dismissed. This is not necessarily supposed to be a mini-trial in any way. It's supposed to be dealing with situations that are uncontested, because if there is a problem with it, file a regular lawsuit, do full discovery, and do whatever you want to with it.

Now, that's a -- that's probably not fair to a judge sitting there listening to this and having ten of

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those, and he doesn't want to hear all that kind of stuff, and I do understand that. I think we probably ought to talk about the practicalities of it some; and I think Tommy probably knows that more and a lot of you do, so I particularly want to hear from the court personnel about that; but I think originally when we did those two rules the application was to be verified with respect to debt and ownership of it and default; and that was what was supposed to be verified; and if there was an issue with that in any way then you would file a regular lawsuit and get into it, and you get into all these issues because now obviously you have pooling of all these mortgages, you've got entranches, you've got it sold with different levels of assets and collectability; and the one commonality of the marketplace is you have a, quote, mortgage servicer, which was added to the statute; and that's the party to whom the payments are being made.

And the old concept of owner and holder sort of works in the sense that if you went into Frost Bank and you got a mortgage and you paid it back to Frost Bank, then you know who the owner and holder is. Now, what happens now is you have -- this is not necessarily in just a single family. It's in the commercial, it's in all of it. All these loans are generated. They're put into a pool that satisfies these tax issues and trust issues, and

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then layers of that pool are sold to different investors, and they're rated by the rating agency, and you've got triple A and double A and A and all this stuff.

So what happens is these loans get into a pool, which now the market's having trouble with subprime pool, so I don't know what's going to happen to all that, but when they get into a pool they are in a group of a lot of assets in that pool that go into a trust and then layers of that are sold out to investors. So the only common denominator of that which would be even close to an owner and holder is the mortgage servicer, because the mortgage servicer is the one that knows where all this goes. They know where the waterfall payments go, they know where the defaults are, and none of these investors ever anticipated they're going to do anything with it, because the services are going to do it, and MERS has all this recording and all that in D.C. about where all these tranches are, and so when you get into owner and holder from our old traditional concept of it, the way the market's working on pooling these mortgages, it really doesn't apply, and that's why this is a huge issue about how you deal with it. That's why I think the statute was changed two sessions ago, so you now have the mortgage servicer, who's the one that gives the notices and deals with everything, and that's the person to who the payments

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-- the entity to who the payments are made.
HONORABLE MARK DAVIDSON: That is who is making the application to foreclose.
MR. BAGGETT: That's right, and that's the closest thing you're going to have to who the owner and holder of the debt is.
HONORABLE MARK DAVIDSON: Okay. So need the application filed with the court have a copy of the assignment or whatever the agreement is that authorizes that entity to do that?
MR. BAGGETT: Well --
HONORABLE MARK DAVIDSON: Or can a naked stranger to the original transaction come in and seek foreclosure of the lien without proof that they have standing to do so?
MR. BAGGETT: Right. And that's a good question. Manny, you want to --
MR. NEWBURGER: I'm just curious, if I could ask a question, isn't lack of standing an affirmative defense that's waived if it's not pled, and if the rules simply have Rules 93 and 94 applicable to this proceeding, doesn't that answer the question?
MR. BAGGETT: Did you hear that, Judge?
HONORABLE MARK DAVIDSON: I did.
HONORABLE PHIL JOHNSON: Let me say, I'm not

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sure, when you say standing, standing generally goes to jurisdiction and goes to whether something is void or not, so when you say standing you need to be a little more discriminating.
MR. BAGGETT: Judge, let me butt in. What we're -- the rules are very important. I don't have any question about that, but the problem here, let's think about who would be the owner and holder in a situation where it's a mortgage that's one of 5,000 mortgages in a pool and that pool has been put together where you have triple A investors, double A investors, B, double B investors, and the only commonality of dealing with that pool of debt is the mortgage servicer to whom the payments are made, and the rule, 92 -- well, I mean, our regular rule was amended to put that in there for that reason.
Now, this doesn't necessarily become a big issue if you just have a traditional situation where you've got the party who originated the loan as the holder of the debt. That's not too difficult, but when you get -- I don't know how you get proof of all that. I mean, you would have to go through all those layers of here's the trust, here's the parties who have the different layers, here's the mortgage servicer.
HONORABLE MARK DAVIDSON: What they've been doing in Houston for the judges that require it is coming

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up with a one piece -- a single piece of paper that the, you know, ABC Mortgage Company does hereby assign the rights to collect and foreclose on any lien to the XYZ Bank, and that the XYZ Bank that is seeking the relief and that is what we require, but there are -- the rule is silent as to whether this is required, but generally --
MR. BAGGETT: That's true.
HONORABLE MARK DAVIDSON: -- it takes one piece of paper.
MR. BASTIAN: There might be an easy solution to all of this because just about every foreclosure referral that comes from a mortgage servicer always says "The investor is," and the investor is the person that that servicer ultimately is going to be sending the principal and interest to. So it would be a very simple thing to just say "The investor is," blank, "the mortgage servicer is," blank, because that's who the borrower is making their payments to, so you kind of have the fail-safe that the borrower knows, well, this is who I've been making the payments to. Plus if it's a Federally insured mortgage, that borrower has to know, and I think it's included in your materials the definitions of servicer and what the servicer does.
So if you had that "the investor is," and that kind of takes care of -- it's kind of a fail-safe in

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itself in that five years from now somebody comes in and says, "Okay, I paid or I think I paid that and somebody else is suing me," you go back and say, "Well, who was the investor," and then you have the mortgage servicer who is the money maid, and that's real simple for people to provide because that's what your lender's going to be sending to you when you do a foreclosure and initiate the foreclosure, and it basically just has transparency and it has full disclosure on the parties and the roles that they play. The big thing that's kind of the fly in the ointment of all of this is MERS because MERS is going to be the mortgagee of record, and that kind of changes things.
MR. BAGGETT: Explain to people what MERS is.
MR. BASTIAN: Well, MERS is going to be the mortgagee of record. In about 60 percent of all loans MERS is going to be the mortgagee of record, but all MERS is is a registration system. That's all it is. It really is a piggyback on what happened in the securities market back in the early Seventies when Wall Street was exploding, and back in those days whenever you bought and sold stocks or bonds you had to have a paper certificate. Well, the back rooms couldn't keep up with it, and Wall Street almost cratered, and they came up with a book entry

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system that everybody is familiar with today where loans are bought and sold, and that's basically what MERS is. It's just a listing of who has all the beneficial ownership interest in a mortgage, and that's going to be the investor, it's going to be the mortgage servicer, it's going to be the subservicers. It gives you four or five, six pieces of corroborating information about the borrower and that particular loan. I mean, it has the detail on their status sheet that says, "This is when the loan was made, here is the borrower, and here's the amount of the loan." I mean, all that information is right there so that if the loan is registered on MERS it's real easy to determine all the different parties in the transaction, and that's the way the world's going, so maybe that's kind of the place we need to be going.

MR. BAGGETT: But MERS is in D.C. and it's national and --

MR. BASTIAN: Yeah. It is the book entry that's referenced in 51.001 as the book -- the book entry system. That's what MERS is.

HONORABLE MARK DAVIDSON: Well, all I'm saying is I don't -- I see reasons for the rule to be one way or the other, but I think the rule should be clearer as to whether capacity, standing, ability, power, call it what you will, has to be affirmatively proven within the

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four corners of the papers filed with the court or whether the verified application without any paperwork being attached is enough to require a judge to sign the request for relief.

MR. BAGGETT: Right. That's fair.

MR. BARRETT: Judge, I think that's a very good point. This is Mike Barrett, and I know we've had this difficulty. There really isn't such a document, and maybe, Larry, you might explain mortgage servicing rights because the servicer usually acquired their position in the file through the purchase of MSRs. There is an organized market in MSRs that really makes up maybe as much as 40 to 50 percent of any mortgage company's assets, and they acquired this -- their status of being a servicer through the purchase of an MSR most of the time, or they did it themselves, they created their own loan. So finding a document that says, "I am the owner and holder, and I hereby grant to the servicer the right to foreclose in my name" is an impossibility in 90 percent of the cases. So we're going to have to deal with that particular issue, and an understanding of who the servicer is and what an MSR is may be important to the transaction.

MR. BAGGETT: Okay. Judge.

HONORABLE BRUCE PRIDDY: Yeah, in Dallas we've wrestled with this issue, and I think most of the

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courts in Dallas require some sort of assignment of the note to the applicant so the applicant is actually the person or the entity that has the rights under the --

MR. BAGGETT: Judge Davidson, can you hear that?

HONORABLE MARK DAVIDSON: Most of it.

MR. BAGGETT: Speak up.

HONORABLE BRUCE PRIDDY: And what the -- happens is they just execute a document like Mr. Barrett says doesn't exist. They just create one for the most part sometimes, and the servicer signs it themselves saying that it's been transferred to whatever entity they name as the applicant. I think we can avoid a lot of problems if we specifically allow the servicer standing under Rule 736, because I think it's -- we don't specifically allow the servicer to proceed, and I think if we tie in with the Property Code provision that the servicer can proceed with foreclosure if certain circumstances are met, if we tie into that in the rule I think we'll avoid a lot of these problems.

MR. BAGGETT: Yeah, I think you might be right because whatever vehicles we have, you do have a servicer if there's multiple parties, and that is the most logical entity to go forward. We just need -- if we're going to do that, we need to figure out how we do it

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cleanly so that everybody understands it.

Manny, did you have a comment you want to make? Larry, you want to talk?

MR. TEMPLE: Mike suggested I do that and then he did it so well there's nothing for me to add. That really tells you what the servicers do, and I just wonder if you added into Rule 736 in what has to be pled just a statement that the person, the movant, is either the owner or is the servicer with the power from the owner to --

MR. BAGGETT: Yeah.

MR. TEMPLE: -- therefore proceed.

MR. BAGGETT: And swear to that as part of the application process. Judge, would that do it?

HONORABLE BRUCE PRIDDY: Perhaps.

MR. BAGGETT: Okay.

HONORABLE BRUCE PRIDDY: One of the other concerns I have is that most of the applications, the rule says it can be on information -- it can be on personal knowledge or information and belief, if they state the basis for information and belief. Nearly all of the applications I see are on personal knowledge, and you can tell that there's no way that one person can have personal knowledge of everything that's in there.

MR. BAGGETT: That's true.

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MR. BARRETT: Exactly.
HONORABLE BRUCE PRIDDY: It's just -- to me, I think we need to massage it a little bit and not encourage folks who do this, because it really kind of devalues the idea of personal knowledge in my court because of what they're saying they have personal knowledge to they can't possibly have personal knowledge to.
MR. BAGGETT: That's probably right.
HONORABLE BRUCE PRIDDY: And so I would like to have some tweaks of that.
MR. BAGGETT: And we shouldn't write the rule in a way that they can't possibly comply with it. That's not very smart.
HONORABLE BRUCE PRIDDY: Right. But they can do it if they do it on information and belief and just say that it's based on their records, but no one does that. They just say they have personal knowledge, and you can't have personal knowledge that a loan occurred in 1978.
MR. BARRETT: That is exactly right. Some of these companies are servicing six million mortgages. The records with those mortgages are spread out in cities across America. The clerk who is preparing the document the judge refers to is usually an employee for less than a

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year or two, and there's no way they know, so you're absolutely right, Judge.
MR. BAGGETT: Yeah, but we also -- we've also got to write it in a way that they take enough time and effort to make sure that it really is the right servicer doing it. I don't want to go so far on the other side that they just say "slap it on them" once they get in the door, and that's all you've got to do. They ought to take -- it's a foreclosure. They ought to take time to make sure it's the servicer that's doing it. Whatever that means. Okay. Other comments?
MR. REDDINGS: Mike?
MR. BAGGETT: Yeah.
MR. REDDING: Mike, I was just looking at 736. You know, there is no definition of "applicant" in it.
MR. BAGGETT: Well, I don't remember what it says.
MR. BASTIAN: That's exactly right.
MR. BAGGETT: Yeah, that's true. Maybe we just define "applicant," and the applicant really would be the mortgage servicer.
MR. BASTIAN: Yeah.
MR. REDDING: Or the mortgagee.
MR. BAGGETT: Or owner and holder or

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mortgage servicer.
MR. BASTIAN: And the definitions to 51.002 were done after Rule 735 and 736 were drafted, and that's one of the things that we asked the Supreme Court to look to, is to marry those two ideas and make 735 and 736 now a master definition in the foreclosure statute.
MR. BAGGETT: Yeah, that's right.
MR. BASTIAN: And what we're talking about would probably be taken care of. I mean, it needs to be more specific, but --
MR. BAGGETT: Yeah, because the mortgage servicer definition that y'all dealt with is in the probate -- I mean, in the real property law, not in the rules. So we clearly need to make the rules reflect what's in the foreclosure law, and maybe that's a way to do it. What do you say, chief?
MR. BASTIAN: No, I agree. Because that's who the borrower is making their payments to, that's who they assume is the mortgage servicer. I mean, I've tried a bunch -- or had a bunch of these hearings before judges, and they think the person that they're making their own home loan payment to is the owner and holder of the note. It's always the mortgage servicer. I mean, they don't even know that, so and that's kind of the fail-safe because that's who the borrower expects to be

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enforcing this note, not some, you know, Bank of New York as trustee for series XYZ home equity loan --
MR. BAGGETT: Pool No. 216.
MR. BASTIAN: That just creates problems.
MR. REDDING: Well, the other problem -- Judge, this is Tim Redding. The other problem that I see -- and, Tommy, you and I talk about it regularly -- that we have a bunch of servicers that are corporations or trusts attempting to foreclose on behalf of other trusts using a power of attorney, and I don't think that's really proper. I mean, we all kind of turn a blind eye to it, but I think that's an issue that's out there that somebody could use to potentially attack a foreclosure.
MR. NEWBURGER: That's what basically happened in Florida where MERS has been held as being unauthorized practice of law by a few judges when they filed foreclosures.
MR. BAGGETT: Speak up. Speak up, Manny, so the judge can hear you.
MR. NEWBURGER: That's what's happened in Florida where some judges have decided that MERS' attempt to conduct a foreclosure as the applicant was an unauthorizerd practice of law. Now, they've got some really good arguments for why they think that's wrong, but that's been a major battleground over in that state.

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MR. BAGGETT: But all MERS is is a recording vehicle, right?
MR. NEWBURGER: Well, but they've been filing foreclosures in the name of MERS. I don't think anyone is doing it anymore since judges decided that that constituted an unauthorized practice of law, but --
MR. BASTIAN: Well, part of that in Florida, their foreclosure statute says only the owner and holder of the note can bring the foreclosure, and MERS wasn't the owner and holder of the note, and yet everybody was pleading them as the owner and holder of note. All they were was the mortgagee of record in the land title records, and it got everybody confused, and like anything new, it just created problems.
MR. BARRETT: Well, MERS was at great -- greatly at fault for creating all of those impressions. They may be supposed to be merely a registrant, but they haven't acted as a registrant. They have acted as a for-profit business, and they have gone out and tried to get into the default servicing business. At one point in time they considered themselves a huge competitor for doing foreclosure business, and they actually went out and marketed their services to bring foreclosures.
MR. BAGGETT: They've quit doing all that, right?

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MR. BARRETT: Well, I don't know whether they have or not.
MR. BAGGETT: Okay.
MR. BARRETT: It's a big company. You might ask one and they say "We quit," and you ask three others, they say, "Oh, no, we still like your business." They're competitors, Mike.
MR. BAGGETT: All right. Other comments on this, because this is the issue I hear about mostly from judges, which is a fair issue?
HONORABLE PHIL JOHNSON: Could I ask a question?
MR. BAGGETT: Yeah.
HONORABLE PHIL JOHNSON: Is this a private corporation, corporate entity?
MR. BAGGETT: Tell him the history of it.
MR. BASTIAN: Well, basically it is a utility of the mortgage banking industry to register loans, so that they can debunk -- so it's just like the Depository Trust Corporation for stocks and bonds. When you buy and sell stock, that's where it's registered so you can figure out who is the owner and holder of that stock when you buy and sell it.
MR. McRAE: Is it cooperatively owned, I guess?

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MR. BARRETT: Yes.
MR. BAGGETT: It was started by Fannie Mae or Freddie Mac.
MR. REDDING: Consortium.
MR. BASTIAN: Well, yeah, there's 270 -- I mean, 2,700 members. It's Fannie Mae/Freddie Mac, VA, HUD, Texas Mortgage Bankers, American Land Title, I mean, all the people that are involved in the mortgage banking industry, has three classes of stock, and it's basically a utility for the mortgage banking industry simply to track all the beneficial interests in loans that are registered on the system.
HONORABLE PHIL JOHNSON: But it's an entity that is owned by stock, stockholders?
MR. BASTIAN: Yes. It's a stockholding entity just like the Depository Trust Corp. for Wall Street.
MR. BAGGETT: Owned by investors primarily.
MR. BASTIAN: Yeah, the investors, the mortgage -- the people that are involved in the mortgage banking industry. It has about 80 employees. That's it. All of its work is done through the mortgage servicers.
MR. BAGGETT: There's going to be a chapter in the foreclosure book added by him on MERS, what MERS is.

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MR. BASTIAN: I'm sure that will solve all of the world's problems.
MS. NEELEY: Mike?
MR. BAGGETT: Yeah.
MS. NEELEY: Just sort of an observation, here's what I'm hearing, that in order to resolve these issues a couple of things need to happen, define "applicant" to include mortgage servicer, regularize the rules with the Property Code, which have been carefully thought out to deal with this issue that's developed over time, and also clarify in the rules what we mean by a verified application so that it's clearer that it can be on information and belief. That's actually in another part.
MS. HOBBS: Yeah, it's pretty clear.
MS. NEELEY: But it's not as clear as it could be in the first part, so we don't get people just, you know, lying in the affidavits, but they actually have a basis for the verified affidavit.
MR. BAGGETT: I think you're right.
MS. NEELEY: Does that make sense?
MR. BAGGETT: We struggled with the issue of what needed to be sworn to in '97 and '99, and we really did not say that the applicant needed to be identified for (1) or (2) because we didn't know that was going to be an

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issue. I think what you said is probably right, if we can figure out how to deal with those three things it probably would help significantly, and we didn't really -- all we did -- you-all tell me when I mess this up. All we did was swear that there was a debt and it's in default. The rest of it didn't need to be sworn to, and the concept was, is that has to be served and everybody knows about it, but when you get it, go to a lawyer, and a lawyer says, "No, you're not -- there's something wrong with that," they file the lawsuit and this just gets dismissed.

MS. NEELEY: And I don't think people realized that these were going to get packaged as much as they are.

MR. BAGGETT: The secondary market has obviously increased, and it's going to keep increasing, and how do you deal with that because we did not attempt to deal with that in '97 and '99. We did not know it was a big issue, and so that's very appropriate to talk about now, but I also want -- I want you guys who are on the consumer side to make sure that what we're doing is fair to the consumers, too.

MS. NEELEY: I was going to make an observation. Under RESPA you have to be a federally related lender, and some of these tax lien financiers are below the one million threshold, and so they are not

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necessarily subject to RESPA, and under RESPA you've got to give the disclosure of the transfer of servicing rights that was added in by Henry B. Gonzalez a number of years ago, but I don't recall, and I don't know if any of you guys remember, a record retention requirement as to how long that servicing right disclosure is actually retained by the lender such that that document would be available to -- I don't think it's retained.

MR. BASTIAN: It's five years.

MS. NEELEY: Yeah. So you don't have that necessarily when you're getting ready to foreclose to establish that as one of the pieces of evidence. So the verification process I think works and then the debtor is going to know, "I wasn't making payments to that servicer. I'm going to contest this, because that's not really the right party," I think.

MR. BARRETT: Good point.

MS. NEELEY: Fred, does that make sense?

MR. FUCHS: Well, I was actually thinking of one other issue that we've seen from the homeowners' perspective; and if you'll look at the rule, the -- it doesn't identify or require actually that the notice or the application state the cause number in the court; and believe it or not, we see homeowners coming in who have received the application and the notice, and there is no

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cause number and no court, so they don't know the judicial district; and the good firms file it and then send it out with a cause number in a court, but there are some firms that aren't doing that. So the homeowner has -- and doesn't know the cause number in which to file a response if he or she wishes to file a response.

MR. BAGGETT: Okay.

MR. FUCHS: And, believe it or not, we've had some problems with law firms then when you call them up and ask them to provide that information, which as a courtesy you would do in any kind of litigation it seems to me, refuse to tell us over the telephone the number that's been assigned to the pending application.

There's the form here, which is implicit it seems that you would state the cause number, but the way the rule is written you simply have to certify as the attorney filing the application that you served it by first class mail and certified mail and along with the notice, but there's no requirement actually in the rule that the cause number and the court actually be included in the correspondence to the consumer, and that's one of the little things that I think need to be tweaked along with the other three issues that have been discussed here.

MR. BASTIAN: That's a real simple one to fix. I mean, that -- there's a lot of little tiny tweaks

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that need to be taken care of where it ends up being a loophole that I think can be taken care of.

MR. BAGGETT: Okay. Anybody else got any comments on this?

HONORABLE BRUCE PRIDDY: On that last issue that Mr. Fuchs brought up, there is one particular firm that persists in doing this, and in my court those applications get denied, and I wrote a three-page opinion which I sent off to the law firm telling them don't do it again. I likened the notice to a citation, and if the citation is missing certain information like that then that would be -- the case would be dismissed or there would be no way to get a default judgment. I kind of analogized to that, and I believe that fair notice requires them to tell the -- to not send the notice out at the same time. What they do if they're in another city, they send the -- Fed Ex the application to be filed at the same time they send the notice out, and so actually the notice is sent out the day before.

MR. BAGGETT: Right. They don't know what it is.

HONORABLE BRUCE PRIDDY: The day before, and I just don't think that's -- that that's allowed, that you have to file it and then have the notice so you can give the borrower the notice of the court and the case number

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so they know where to file the answer and what to put on the answer, because if you don't have the case number the answer is going to get lost.

MR. BAGGETT: Okay. I see you shaking your head yes, and I agree.

MS. KELLUM: I agree with judge, and that's -- I don't know if you would call it an issue, but it's certainly a concern in our court, the service process, period, because we have a lot of attorneys that we have to double-check and make sure that service was proper and everything, because it's -- we just are concerned with due process.

HONORABLE BRUCE PRIDDY: Yeah. And I have two issues that I was going to -- wanted to bring up, and that was the one of them, and that's the outsourcing the citation in the service of process to the applicant's law firm, and that's what they do, with a notice that is instead of the citation and then the service where they have to send it by regular mail and certified mail is -- stands in for the service of process. Now, the vast majority of the applications in our courts are default. Now, either that means the borrowers don't have any objection and everything is fine, we can just go forward, or it means the borrower may not be getting notice --

MR. BAGGETT: Right.

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HONORABLE BRUCE PRIDDY: -- or may not be getting sufficient notice that they really understand what's going on. I often set a final disposition hearing on my applications unless the -- unless a default is -- I can clearly do a default. If they've proven everything they need to prove to get the default, I'll grant the default, but otherwise I will just set a final disposition hearing, and I send notice directly to the borrower, and this is a default situation where the borrower has not answered. About 30 percent of those the borrower shows up, and this is in a default situation, so I'm kind of concerned that the borrowers may not be getting notice.

There is due process concerns, there is the Jones vs. Flowers case out of the U.S. Supreme Court involving the Arkansas tax debt that has some implication here about notice, and I think we need to think about -- I would like to rethink whether going back to real service of process. I think 60 bucks would be a small price to pay in this to go ahead and get -- it would solve a lot of my concerns about due process and my concerns about whether the borrower is really getting notice.

One of the things that I think is the borrowers get a barrage of letters from these particular lawyers. They get all these dunning notices they may have gotten every month -- you know, every month for the last

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ten months and then they get this notice. They may not even open it because it's from the law firm. They just think it's another dunning notice, and they may get it, and they may not even realize it's a court document or something. If they can get notice from the court or notice from personal service or something that really hits home that there's a court proceeding that they're about to lose their house, and I just think that it would probably make sense to have some sort of more official notice than the notice solely from a law firm, and that's just one issue that I want to throw out there.

MR. BARRETT: We may have gotten that one wrong, Judge. What we were primarily thinking of in the old committees and in the past is the size of the cost. $50 is ten percent of the cost of the whole thing, so that's a significant charge when you stack it up and use -- because all of these servicers are losing 40, $50 a day, they want you to go out and hire an expedited service processor, and now you're talking about a hundred to 150 bucks.

When you want to reinstate -- and Texas is the cheapest state in all the country to reinstate mortgages. We are thousands of dollars less than California, so if you lose your job, you get a job, and you need to go reinstate your mortgage, this is the best

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place on earth to do it, and we did it by scraping fees out of the process. Most states use substitute service providers, and in some states the fee for that goes all the way to nearly 400 bucks, so it's a significant expense which is tacked on each and every case, whereas it would be beneficial only to the few who for some reason had a justified reason for not getting the letter, and I don't think not opening your letter is a justified excuse, and then I'd be interested to know when those 30 percent show up, do they have meritorious defenses? Have they, in fact, made payments that nobody discovered until they appeared?

MR. BAGGETT: Yeah, but I understand your issue. You want to make sure they get it, get it in some way that they know that it's different, and I don't -- the cost of the process, I -- you know, the market is just going to have to deal with that issue. If it costs more money, the market is going to have to figure out how to deal with that issue if it's something that we really need.

MR. BARRETT: Well, it's a huge imposition of expense on the debtors. All of these expenses either are paid by the debtors when they reinstate --

HONORABLE MARK DAVIDSON: Paid by the lenders up-front.

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MR. BARRETT: Paid when they reinstate or when they pay off or they're paid by investors, and of course, most of the investors ultimately are insured and that means the taxpayers pay it. 60 percent of the loans are HUD loans, and all the loans that don't go back, are not reinstated, wind up being paid for by Federal funds out of HUD. That's plain tax money, so the market you're describing is us, the voters, the taxpayers, the citizens.

MR. BAGGETT: Ultimately we've got to pay for everything, but that doesn't mean we're not going to do anything.

MR. BASTIAN: Let me ask the clerks, if you-all sent the notice, how big an imposition is that on you-all, to have the independent hand-off that Judge Priddy is talking about?

HON. AMALIA RODRIGUEZ-MENDOZA: When we file the application or the -- and we have to make a copy of it because it's electronic, so that's an expense that will be -- have to be charged on the number of copies that we have to do to file the -- to submit the citation. So it's an added work to our employees, but, you know, I think we'll have to just deal with it.

MR. BASTIAN: Okay. That may be kind of a philosophical thing that we have to deal with. I mean --

MR. BAGGETT: Yeah, Manny.

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MR. NEWBURGER: We've got options elsewhere in the rules that -- or in the statutes that let us have alternate ways of service. For example, on foreign judgments you can let the clerk give notice or you can let a party give notice. What if you simply provide the option of either the clerk or service and mandate that if they're going to have the clerk do it, they've got to deliver the extra copies to the clerk's office so the clerk's office doesn't have that burden, and I don't want to step on Amalia here. It may be the solution is not to allow e-filing. I don't know if e-filing is a bad thing here, but if it's a good thing for you-all --

HON. AMALIA RODRIGUEZ-MENDOZA: It's a good thing.

MR. NEWBURGER: -- they have to deliver the copies, but certainly we've got a precedent for giving parties the option of service or a clerk doing a mailing.

HON. AMALIA RODRIGUEZ-MENDOZA: I think the way we've solved that is we actually make the copies and then we charge the attorneys for the copies and then --

MR. BASTIAN: What if the attorney had to send to you the notice and then you just put it in your envelope? I mean, because you already have the Pitney Bowes machines that just run it through, and it's going to come through from your court if the attorneys supplied

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that to you.

HON. AMALIA RODRIGUEZ-MENDOZA: So then we'll end up with two methods, the e-filing method and the manual processing, which, I mean, it's workable. I'm not saying it's not. I'm just trying to bring that --

MR. BAGGETT: It's going to cause you an expense.

HON. AMALIA RODRIGUEZ-MENDOZA: -- into it.

MR. REDDING: This is probably a ridiculous idea, but I always look for the simplest solution.

MR. BAGGETT: Yes.

MR. REDDING: Could you change up some of these rules such that when that final notice is sent to them or the document is -- or the actual order or the application for the order is sent to them, that you put it on the outside of the envelope?

MR. NEWBURGER: Lawyers can't do that. The Fair Debt Collection Practices Act forbids any notices on the outside of an envelope that are sent from a debt collector, which includes any of the law firms conducting foreclosures, and the limit is the name of the addressee and the return address of the sender and their name if it doesn't reflect that they're in the debt collection business. If firms like Mike start putting stuff on the outside of envelopes, that's a guaranteed class action.

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MR. REDDING: Good reason not to then.

MR. BASTIAN: Well, there's probably an unintended consequence with this whole service thing because, as most of you-all know, in the rules if nobody files a response you're entitled to an order, but we have a matrix of all the courts in the state, and almost ten percent of them require a hearing, and I think many times they require a hearing even if it's a default simply because they're worried about what Judge Priddy is, did somebody really have notice, and that court wants to be kind of the arbiter, a fail-safe, or whatever you want to call it that --

MR. BAGGETT: They're also worried about the applicant.

MR. BASTIAN: Well, you know, all of those kind of things and kind of gets back, and then really what happens is because of that and having the hearing and even judges the way they're looking at these things, is that is the burden of proof to prove up one of these Rule 736s, is it now the burden of proof for motion for summary judgment type proof or is it for a default proof? And those are two completely different things. If you had personal service on somebody, I think every judge would just go on and sign the order and you would be done, but when you have the service like we have now then judges are

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requiring hearings that really aren't required in the rule, and then even if they don't have a hearing, they're going to go through and look at the verification or your evidence that you have and they're going to use the motion for summary judgment standard, which many times means that you've got three or four months delay to go get all that stuff because the standard is so much different.

So it has kind of an unintended consequence when you have judges that are a little bit concerned about did the borrower really get notice and then they end up vetting the files to make sure that, you know, everything is kosher.

HONORABLE MARK DAVIDSON: Well, let's start with the -- I hate to back it up, but I wasn't on the committee at the time. What is the purpose of judicial review? If it is not to make sure that the -- that everything is copacetic, then why are judges even involved at all?

MR. BASTIAN: Well, because that's -- the Constitution required a court order.

HONORABLE BRUCE PRIDDY: But why did the Constitution require the court order is the question?

MR. BASTIAN: Well, but there's kind of an answer back to that, and that was the way this -- the core principle the way Rule 736 was set up, we had the

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assumption that 50 percent of all the home equity applications that were going to be filed were going to be uncontested, and that was -- we figured that would be maybe a high number. In truth it's probably very, very -- I mean, it's very low. I mean, a whole lot less than that have ever been challenged, and this whole idea of the rule was if nobody was going to contest that you basically have a foreclosure like you do now, and it just goes through the process. That was the whole idea that Rule 736 was set up, so that if somebody didn't contest that you didn't clog up the courts. If they did contest, you had all of these things in place so they could come in and say there's something wrong with this, the servicing, the loan, whatever it is.

MR. BAGGETT: Let me get -- mechanics of how we get an order are very important, and they've got to do what we need to protect people, but don't forget what we're doing here is all we're doing is getting an order saying you can foreclose. You've still got to go through the whole process that you do anyway, so yeah, there is judicial participation because they've got to make sure that what we say is done is done, but it does not immediately take away from all the normal foreclosure issues. All you've got is an order and then you go do whatever you've got to do on top of that.

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HONORABLE MARK DAVIDSON: With respect, no judge wants to have Marvin Zindler in their reception room when they get to the courthouse in the morning wanting to know why you threw the Widow Jones out of the house. We had a judge who did that on a homeowners association deal down here a couple of years ago, and the judge essentially was hounded off the bench, resigned.

HONORABLE BRUCE PRIDDY: I had one judge, one of my colleagues just -- we're civil judges. Harris County and Dallas I think are the only -- or I guess there's a few that are purely just civil. We just do civil cases, no criminal cases at all, so we don't sign death warrants. We can't do a capital punishment case, and one judge confessed to me that this is the closest thing that he has to a death warrant, is that we're signing an order allowing someone's house to be taken away, and --

MR. BAGGETT: I'm not disagreeing that there ought to be a process for that, but we've got to balance between how much we put back on the courts to do all that versus what we -- if it's going to be the uncontested, is it going to just clog up the docket so that half your cases are these issues.

HONORABLE BRUCE PRIDDY: Right. And that's the next issue that I had, is there's ambiguity on the

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default situation, what Mr. Bastian was pointing out, and I think we need to clarify that. In the rule (8)(a) says that you have to prove the certain elements before you can grant an order, but then sub (5) talks about default, "You shall grant if there's no answer and the notice is on file for ten days" or something like that. The question there is do they still have to prove the elements in the application? Do they have to prove everything that's -- I believe it's the elements of (1) --

MS. DOGGETT: (e).

HONORABLE BRUCE PRIDDY: -- (e). Does that have to be proved in the application or does the fact that they don't answer -- do you accept all allegations as true? I don't think you do that. The normal default situation doesn't seem to apply because we have this obligation to bring forward facts in the initial pleading, in the application. So there is to me an ambiguity of whether before you grant a default you have to make sure that the -- all the elements of (1)(e) are proven or not. (8)(a) seems to say that to me.

MS. DOGGETT: Why do you have to have a hearing to prove it?

HONORABLE BRUCE PRIDDY: Oh, you don't have to prove it, but you have to analyze the application to see if they've presented evidence. I believe it's

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evidence as would be admissible at trial, is I believe the standard in the rule, to see if they established evidence instead of just an allegation that these necessary elements are established, and that's -- if we can clarify that, if you want to say that if there is no answer we assume all facts as true as in the normal situation, we should make that explicit, and that will streamline a lot of -- a lot of things if we make that explicit.

MR. BASTIAN: Yeah, the rule says "as will be admissible in evidence" and then that's it. It doesn't really say that's the way it is, but you certainly have this two different standards of proof, motion for summary judgment proof or just plain default proof, and again, that's that philosophical difference, and it may go back to either because you don't have personal service -- I mean, I don't know all the reasons why, but you'll see those variations in lots of these courts.

HONORABLE MARK DAVIDSON: Well, a lot of -- a number of my colleagues say, "We didn't ask for this job, but if we have it, then, you know, there must be a purpose behind us being required to be the gatekeepers to make sure all procedures have been followed," and there are other judges that take the position, "These people borrowed the money, they didn't make their loan payments, end of the road."

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The rules should be as explicit and clear as possible as to what has to be there in order for one of these to be granted and exactly what the procedure should be, and the current rule is in my view no as clear as it should be one way or the other.

MS. NEELEY: Okay, for what it's worth -- and Larry and Kelly can kick in if I'm getting it wrong, but I believe if you go back to the legislative history there was a colloquy on the floor between Mr. Woolins and Harriet Earhart about the legislative intent of this particular section in the Constitution, and the concept here, there's a tension between normal foreclosure, posting at the courthouse door, no judicial action at all, judicial foreclosure, something in between, and the concept that was put in here was that there needed to be some simple mechanism whereby the debtor would have an opportunity to say, "Well, wait, there is an irregularity in this transaction and the lien is invalid," and by having this sort of intermediate process, there was an opportunity for the debtor to say, "The loan is irregular, so I really should be off the hook."

It was not conceptually a judicial foreclosure or a requirement that you had to go through all of this additional proof that we wouldn't do in a courthouse steps foreclosure. So the whole underlying

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objective was just to create this opportunity for the debtor to come in and say, "Wait, wait, wait" --

MR. BAGGETT: Yeah.

MS. NEELEY: -- "irregularities," that's it. And if they didn't have an irregularity then, you know, they had their opportunity, and that was it.

MR. BAGGETT: I think you're right. We're trying to deal with the balance between these that there's no problem with and clogging up the courts with those. However, I agree with the judges that if there's something that says you've got to do it, they ought to be able to be comfortable that's what we've got to do. Now, what that's probably going to mean is we're going to put more on the courts, send out notice or this, that, and the other, and we didn't want to burden the courts, overburden the courts with this process. That's the balance we're trying to get to.

MS. NEELEY: Well, I think the real balance is --

MR. BAGGETT: Judges and the coordinators and the clerks. You have to send out extra notices.

MR. TEMPLE: Mike, I agree with Karen. I think the original concept of the court order that she said was somewhere in between the standard and nonjudicial foreclosure that we have on 99 percent of the cases and

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the provisions that are available for judicial foreclosure, and while the law doesn't quite say this, the concept was that if the application is filed and there's no response to it, what the court is effectively doing is saying "We have not been provided with any reason why the lender ought not to be able to proceed with the standard nonjudicial foreclosure." That's all that is. It's not really giving the court the responsibility of saying, yes, we think Widow Jones ought to be kicked out of her house. It's more the negative of we see no reason why, have been provided no reason why, they ought not to be able to proceed with a standard form of the foreclosure.

MR. BAGGETT: I don't disagree with you, but I think that we've got to make the rule have the basic elements in there that does what we hope it does, which is they actually get notice, and it actually is the right party --

MR. TEMPLE: Absolutely.

MR. BAGGETT: -- trying to get it, and there's a default, and we've got to get to a place to where we do that without overburdening the judges and the courts with it. Now, how you get to that balance, I don't know.

MR. FUCHS: Mike?

MS. KELLUM: Can I -- I'm sorry.

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MR. FUCHS: Go ahead.
MS. KELLUM: I was just going to say in the CYA world that we live in today if you've got a judge like the judge that I work for, he's not going to sign a leaf that blows in the window, and he's going to want some substance behind it.
MR. BAGGETT: I understand that.
MR. FUCHS: Currently under the rule we allow for service of -- and showing that service has been completed just on these certificate of service by the attorney for the applicant. One -- and that the judge can grant the default if there's no response within time and that certificate of service has been on filed for ten days. One additional -- part of the concern is shady attorneys who are perhaps not complying, and one possibility would be some extra requirement of proof of service; i.e., because there's the i.e. that the attorney who seeks the default would have to show a copy, a copy of the green card having come back or a -- and show that if it does -- if the green card didn't come back, a copy of the envelope that's come back showing it was unclaimed and a copy of the envelope showing it was mailed by first class mail.
I mean, you can still play with those, but it's harder on the certified mail, and that would give

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some at least additional confidence to the judiciary then that the attorney had indeed complied with the notice requirement other than taking the attorney's word. It doesn't deal completely with Judge Priddy's concern about the fact that the consumer may ignore the notice because he or she may have gotten five or six --
(Sirens)
MR. BAGGETT: Here's some consumers coming after us, all the sirens.
MR. FUCHS: -- but sort of in keeping with the concept that we assure that there's notice yet that it's a streamlined process. I just throw that out.
MR. BASTIAN: I'm going to jump in here on the green cards because that's a real pain, but now with the U.S. Post Office you can get a certified number, and there is just a printout that you ought to be able to attach that. I mean, that's coming from the post office that says, "This was delivered to the post office and there's the proof" and you attach that, so you don't have to have the green card, because to get green cards is just a royal --
MR. BARRETT: Well, there was a client of ours two years ago that decided they were no longer going to keep green cards, and the reason they did it is 37,000 square feet was the amount of space that they recovered

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from where they had been storing green cards. Again, I've got to tell you that the cost of all of this is monumental. Most of these actions are redeemed by reinstatement, so every time you add cost to the process, you add cost to the people who are trying to reinstate their mortgages, and in an era when holding onto your home is a very difficult process, raising the cost of retention is probably something that we should be very circumspect about.
It's costly to do a green card process, probably as much as 20, 25 bucks a file by the time you pay for the postage and pay for the storage and pay for the clerical manipulation of it. Barrett Burke, for example, is an entirely paperless outfit. We don't keep paper. If we've got to keep green cards then we're going to have to go create a place to keep the green cards.
MR. FUCHS: But do you scan the green cards after you get them back so that --
MR. BARRETT: If the rule said that, but we've got a lot of judges that say, no, I want green pieces of paper.
MR. BASTIAN: What I found with judges on the green card, lots of them have their computer on their desk and I say, "Judge, here is the number, type it in, U.S. Post Office, type in the number." They do it

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themselves and they see it pop up, and that's proof.
MR. FUCHS: That's good enough.
MR. BASTIAN: That's good enough.
MR. BARRETT: Yeah.
MR. BASTIAN: Because that's the U.S. Post Office. You have an independent source that comes in and says that was actually deposited with the U.S. Post Office and then you don't have to mess with the green cards unless somebody wants to mess with them.
MR. BAGGETT: Okay, let's do this. Let's try to figure out some way we can do it that is least obtrusive to you guys and expensive, but judges are more comfortable that they're getting the durn papers that they need to get, and we'll work on that and see how we get into everything, but I don't -- and I don't -- the three that you said are fine, defining "the applicant" is important because you've got to have the right party to do that, regularize it with the Property Code is important, and verifying the application.
MS. NEELEY: What does that mean.
MR. BAGGETT: Yeah.
MS. NEELEY: And then if we can enhance the notification process to give comfort that there is due process and that the debtor really knows that they have this opportunity, then I think maybe, Judge, some of the

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concerns can be allayed, the person didn't respond because they didn't have anything to say, but they really knew they had an opportunity. That's key.

HONORABLE BRUCE PRIDDY: It would be almost like in terms of a show cause order, tell us a reason why I shouldn't let the lender foreclose, come up with a reason if you don't -- with the standard being if you don't come up with reasons the court's going to grant it.

MR. BASTIAN: And that could be put in the rule. I mean, I think that could very easily, because that's your standard that you're looking for.

MR. TEMPLE: That was the concept originally.

MS. NEELEY: Yeah.

MR. BASTIAN: Say this is the standard you use, because right now you have some judges saying the default standard and some judges saying a motion for summary judgment standard.

HONORABLE BRUCE PRIDDY: Right, and that's something we need to clarify because I think (8)(a) to me seems to indicate that if there's no answer you still have to use, as Tommy said, the summary judgment standard, and I don't know if that was intended in a default situation. If it wasn't, that needs to be clarified that that -- that in a default situation the lender does not have to prove

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all the elements of (1)(a).

MR. BASTIAN: To me that's just drafting. I think we can come up with the words for that. I mean, we have two judges that are very -- and Fred that's very interested in that language about what is the standard, and we ought to be able to come up with the standard that's easy to enforce.

MR. BAGGETT: Okay.

HONORABLE MARK DAVIDSON: I agree.

MR. BAGGETT: I think those are the fair issues. Yes.

MS. HOBBS: We need to give the court reporter a break.

MR. BAGGETT: Need a break? We don't have coffee or anything? Okay. We're going to take about a ten-minute break.

HONORABLE MARK DAVIDSON: Okay. And I have to get on an airplane to San Diego, which is why I couldn't be there today.

MR. BAGGETT: Okay.

HONORABLE MARK DAVIDSON: I'm speaking at a nationwide conference, and I'm sorry, but when they give me free first class airplane tickets to San Diego I go, "Yes, I'll be there."

MR. BAGGETT: We understand that, and you're

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fine. Thank you, Judge.

HONORABLE MARK DAVIDSON: I promise I'll be there live at the next meeting.

MR. BAGGETT: No problem.

(Recess from 10:58 a.m. to 11:09 a.m.)

MR. BAGGETT: Okay. Why don't we do this, we will put that in a committee form and try to come up with something that is not swinging one way or another, kind of comes down the middle and the court people don't get killed in it and that's okay with you-all I assume, and the judges feel okay that they've done what they need to do to make sure everybody got notice and a shot and that's all fair. I don't have a problem with any of that. And then we've got to balance the cost, I understand, so we're going to figure how to do that.

HON. AMALIA RODRIGUEZ-MENDOZA: All in one.

MR. BAGGETT: Easy, easy. Okay. Now, why don't we do tax liens since we solved this other problem so easily, and who wants to talk about tax liens? Because I know what tax liens are. I need to pay them or I'm in trouble. That's about the beginning and ending of what I know about it.

MR. BASTIAN: We need to talk about hearings.

MR. BAGGETT: Hearings? What do you want to

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talk about on hearing?

MR. BASTIAN: Well, under the rule you don't have to have a hearing if there's no response and you've got --

MR. BAGGETT: On this? All right. Sorry.

MR. BASTIAN: That's another one of those philosophical things we've got to kind of wrestle with.

MR. BAGGETT: Okay. All right. Bring up your issue. Now, we've got to get to tax liens because that really is the reason why we're here. We do need to coordinate everything, but we've got to get to tax liens. Okay.

MR. BASTIAN: Well, and again, this may be one of the philosophical things we've got to deal with, and that is lots of judges are requiring hearings even if there's no response, and part of this may be tied up with the service again. But the way the rule is written, that if there is no response filed and the judge is supposed to sign the order and you go do the rest of the things that you have to do to foreclose, and I don't know if anybody has a problem with that or rewriting the rule or something to make sure that you don't have to go have a hearing if there's no response filed, or whether we want a hearing.

HONORABLE BRUCE PRIDDY: One of the things, to clarify, one of the reasons I think some judges have

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hearings is there's really only two ways to get documents that they can consider. One is the application in the materials and the affidavit is attached to that, and then there's also the -- I think rule (6) says at the hearing you can consider affidavits on file. To the extent that supplementation is required, if stuff is not in the application and then they file, like, as Judge Davidson pointed out a lot of times courts will require you file the assignment, wasn't in the original application, they file it later. Can a court consider that? It wasn't attached to the application. Or does the court have to have a hearing and then consider it at the hearing?

To the extent that applicants try to offer documents that weren't in the original application, there is some confusion or some disagreement among the courts of whether they can consider that or whether they have to have a hearing to consider that, and that's one reason why I think you have some hearings.

MR. BASTIAN: I think that can be drafted, too.

HONORABLE BRUCE PRIDDY: No, we can draft around it. We just need to be clear on what we want.

MR. BAGGETT: Okay. So what are we going to draft? What are we going to say about the hearings?

MR. BASTIAN: Well, I think what we do is

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come up with some suggestions in the group and look at it after you see something work in the real world.

MR. BAGGETT: If on the face of the documents it doesn't appear to comply --

MR. BASTIAN: Yeah, if it's proved up and you don't have a response, then no hearing. But maybe like you're saying, give the judge the discretion if he wants -- well, see, that's the catch 22. A lot of judges are doing -- you don't know why they do it. Because I've had a lot of judges just do it, as soon as you show up, nobody shows up, they give you the order. I mean, it's kind of like an exercise in futility, but I mean, if it's like you're saying, okay, here is the particular reason why you have to have a hearing and that is you haven't supplied it to the judge's satisfaction, then the judge has a hearing and that kind of also gives the enforcement that, Mr. Attorney, if you don't do it right, then we're going to make you suffer and have a hearing on this thing. But if you do it right then there's no need for a hearing.

HONORABLE BRUCE PRIDDY: Right, but --

MR. BASTIAN: That would be kind of the discipline that makes sure that the attorneys do it right when they file the application and all the proof then. Maybe we can do it that way.

MR. BAGGETT: Well, I guess that gets to the

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point, well, you need to read it and make sure they did what they did, and if they didn't or you have a question about it, then have a hearing. That's going to put it on the judge to do all that.

MR. BASTIAN: Well --

MR. BAGGETT: All right. We'll work on hearing, too. All right. And we've got as much time as we need. We're going to have lunch and all that stuff, so I'm not hurrying through it. I want to make sure we cover tax liens. Who wants to talk about it first? Which one of you were most active? Kelly?

MS. RODGERS: Me.

MS. NEELEY: Kelly.

MR. BAGGETT: You're up, Kelly.

MS. RODGERS: When we came into the last legislative session this issue on tax lien transfers and liens and foreclosures had been addressed in some prior -- prior legislative sessions, but for whatever reason the mortgage lenders were just beginning to see some of these tax lien foreclosures come through, because there's a super priority lien with the tax lien that transfers from the taxing authority to whoever pays off the taxes, and it trumps the first lien purchase money mortgage that's out there. So sort of the impetus for all of this was that some of the mortgage companies and mortgage lenders were

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getting notices that a foreclosure was about to take place, you know, four days before the foreclosure was about to take place, and they were obviously interested in going in and paying off the -- paying off the tax lien transfer loan.

As far as the -- do you want me to go through some of the more detail? Essentially the tax lien lenders were not regulated by any state agency of any sort, which was the only -- you know, the only lender in the state of Texas that wasn't regulated. So one of the things we did was pass House Bill 2138, which put them under the regulation of the Office of Consumer Credit Commissioner who is currently in the process of promulgating rules dealing with how those folks are licensed and what kind of fees and expenses they can charge.

MR. BAGGETT: Who has to be licensed?

MS. RODGERS: The tax lien lenders have to be licensed by the Consumer Credit Commissioner's office now, and so we've got the regulatory side of it and then we've got Senate Bill 1520.

MR. BAGGETT: Put a mark in your mind, and I'm going to go back to you, but let me tell you my reaction to this, having never ever seen anybody buy one or sell one or whatever. From a foreclosure standpoint I

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never worried about ad valorem taxes being a priority because they had to be judicially foreclosed.
MR. REDDING: That's right.
MR. BAGGETT: So it didn't bother me, and then I found out all the sudden they don't have to be judicially foreclosed and they have a priority and you don't give notice to the first lienholder. I said, "How in the hell did we get there?" I'll just be honest with you. That was my reaction to it.
MR. REDDING: Well --
MS. RODGERS: That was the reaction of a lot of the industry.
MR. REDDING: Yeah. Mike, if I can interpose, because this was an issue obviously for the title industry because --
MR. BAGGETT: Yeah.
MR. REDDING: -- what you have is you have the tax lien lender claiming priority under the tax code and yet trying to avail themselves of the nonjudicial provisions --
MR. BAGGETT: Right.
MR. REDDING: -- you know, in 51.002 for foreclosure.
MR. BAGGETT: Right.
MR. REDDING: And I don't think you can --

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Tommy and I talked about this. We all talked about it, because it was how do you marry those two together without giving notice? Tax code says you give notice to everybody that has an interest in the property.
MR. BAGGETT: Right.
MR. REDDINGS: And yet the foreclosure --
MR. BAGGETT: And you got it judicially foreclosed.
MR. REDDING: Yeah, and the nonjudicial foreclosure provisions say you only have to give notice to that person that is obligated on the note.
MR. BAGGETT: Correct.
MR. REDDING: So how do you marry those two and still protect them?
MR. BAGGETT: We've been giving speeches like that for 20 years.
MR. REDDING: That's right. That's right.
MS. DOGGETT: Can I add something here?
MS. RODGERS: Absolutely.
MS. DOGGETT: This is Mary Doggett. Oh, he's off the line. In the 2005 legislative session, I represented a small tax lien lender that had been giving notice. I had always advised them that if you don't give notice to the lienholder you're not extinguishing their interest in the property so you need to give them notice,

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but not all the tax lien lenders and in particular one very large company was not doing so, and so they went to one of the representatives and said, "We would like to have some amendment to make sure that everybody is doing what we're doing." They kind of wanted a level playing field.
So Representative Puente filed I think it was House Bill 2491, which started off as a very short one-page bill that basically said if you foreclose pursuant to your transferred tax lien and you use the Property Code nonjudicial procedures then you have to go through and make sure everybody gets notice. That turned into -- House Bill 2220 was amended into it and it turned out to be like a 40-page bill or something. We had very long coattails that session, and that resolved that problem. It didn't resolve the -- a lot of the other issues and that's why we came back this session.
But one of the things that I think, just personal opinion as to address your statement, Tim, is that I think there is a way to marry those two or the idea that you got a nonjudicial proceeding with a lien that could only be foreclosed judicially if it was held by a government unit is because of who's holding the lien and because of the fact -- you know, coming from a background where I filed 5,000 suits a year to foreclose property tax

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liens, governments can handle that. Governments have, you know, their revenue stream set up based on those taxes, and they can predict what's going to happen, but nobody, when I started doing -- representing taxing units, nobody was doing property tax liens transfers because -- unless you had a rich uncle because there was no way to recover other than doing a judicial foreclosure, and you could only get ten percent interest.
I don't know if anybody remembers Oliver Heard, but he was my boss at the time, and he, you know, saw a way to make some money and got the code amended in '95 so that you could get 18 percent interest and do nonjudicial foreclosures and all of the sudden there's this new industry, but the theory was that, you know, if you've got a lien and you're a private entity you should be able to foreclose that pursuant to the most efficient process as opposed to a governmental unit. Now, the tax code has been amended, and there are some nonjudicial foreclosures of tax liens permitted nowadays by government units as well, but the vast majority I think -- Mike, as you said when we talked on the phone, the vast majority are still foreclosed judicially. Okay. That's my speech, Kelly.
MS. RODGERS: We essentially sat down with the tax lien lender representatives, including Mary. We,

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being the mortgage lender folks, and came up with what ended up being an agreed bill, which is 1520, and some of the uncertainties or language in it that may look very odd to anybody else made perfect sense to us when we were doing it.

MR. BAGGETT: Or at least at midnight that's what came out, right, is this?

MS. RODGERS: That's exactly right, and that's what leg. counsel left alone, so --

MS. DOGGETT: You know what this means and I know what this means, so it's okay.

MS. RODGERS: Everybody else can figure it out.

MR. BAGGETT: Kind of like our great rules. We can improve them. We know that we can.

MS. RODGERS: That's right. That's right. But for our purposes, though, you know, we had a model with the home equity loans and the reverse mortgages of putting the foreclosure of tax lien loans, you know, somewhere, as Karen said, between nonjudicial and judicial foreclosure, just to make sure that all the I's were dotted and the T's were crossed and that everybody --

MR. BAGGETT: Everybody got notice.

MS. RODGERS: -- who needed to get notice, and so that was the purpose of this, and because we had

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the model with the rules there, it was very easy for us to punt to a task force instead of trying to figure it out ourselves at the last minute. So that's pretty much the history.

MR. BAGGETT: That's fair, and I think if you do give notice to everybody that's affected and it's effective notice and it's not too expensive, that probably does solve the problems.

MS. RODGERS: Well, and --

MR. BAGGETT: I would assume unless the title companies have got a different issue that I don't know about.

MS. RODGERS: Right. Right.

MR. BAGGETT: You get the notices?

MR. REDDING: Yeah, that was our biggest -- that was our big issue was making sure everybody got the --

MR. BAGGETT: Then you've got to write to reinstate.

MS. RODGERS: And the title industry was at the table, too. I mean, they were very active in this discussion during session.

MR. REDDING: Yeah. No, we were all in favor of these changes.

MS. RODGERS: Right, but everybody -- all

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the issues we've discussed this morning, the notice issues and those sorts of things --

MR. BAGGETT: All apply.

MS. RODGERS: -- are all applicable. You know, once we fix that for home equity and reverse mortgages it's going to --

MR. BAGGETT: It will fit for everybody. Okay.

MS. RODGERS: -- be the same for tax lien.

MR. BARRETT: What form of notice would you recommend be required?

MR. BAGGETT: Right.

MS. RODGERS: In the sense of what the delivery mechanism is?

MR. BARRETT: Yeah. If you were a tax lien lender and you wanted to foreclose the interest of Bank of America, there are 1,191 addresses for Bank of America.

MS. RODGERS: That's right.

MS. NEELEY: Well, that's --

MR. BARRETT: What form of a notice would you have the tax lien lender give to Bank of America that would have any -- we've heard some claims here for due process.

MS. RODGERS: Right, I know.

MR. BARRETT: What form of notice would

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cover due process when there are 1,190 addresses for one client?

MS. NEELEY: That's why we need to address that.

MS. RODGERS: Well, and this was a discussion. This has been a big issue for the tax lien lenders on how they give effective notice even under the --

MS. DOGGETT: And to whom, yeah.

MS. RODGERS: And to whom, and the --

MR. BARRETT: So the process is hard for them. They get served, and it's still hard to get the right piece of paper --

MS. RODGERS: To the right person.

MR. BARRETT: -- in the hands of someone who knows what to do and how to do it.

MS. RODGERS: That's right.

MR. BAGGETT: I'll give you another example, and I don't think it solves the problem, but this does -- 25 days notice to the internal revenue, and I say this in speeches all the time. I've never ever seen a foreclosure where they woke up in 25 days to do anything about it.

MR. BARRETT: That's exactly right.

MR. BAGGETT: Never. Never.

MR. BARRETT: Exactly right.

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MS. DOGGETT: What most of the tax lien lenders that I represent have done is establish personal relationships with the mortgage servicers, and they try to pick up the phone, to tell you the truth. As the industry grows it's not going to be possible.

MR. BAGGETT: That's great, but we can't rely on that.

MS. DOGGETT: Right. One of the things that we realized when we were -- one of the things we talked about when we were working on this bill was at the time that a property tax transfer is closed you're communicating with the property owner and you can get the name of the mortgage servicer, but three years down the road when the guy is no longer to be found and you have no communication, that mortgage servicer might have changed three times, and so the best you can do is contact the holder of the note, and so it was written that way so that if a foreclosure occurs you contact whoever you can basically, and the holder of the notice is sufficient at that point.

But then again you've got that trickle down effect. You know, if you send something to the holder of the note are they going to get it, and so we extended the notice from 38 days to 60 days. Is that even going to be sufficient?

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MS. RODGERS: Right.

MR. FUCHS: The statute simply says the application must be served. I'm curious, was there a legislative discussion on whether that had to be personal service, certified mail, first class mail?

MS. DOGGETT: There was, and --

MR. FUCHS: And?

MS. DOGGETT: The overriding sentiment was that because everybody who was -- had an interest in the property was going to be bearing the expense of personal service, that it was decided that 21a was sufficient.

MR. CULBRETH: Which is consistent with 736, the certified mail.

MR. BAGGETT: Yeah, just certified mail.

MS. DOGGETT: Uh-huh.

MR. BAGGETT: The way we have it now, I guess.

MS. DOGGETT: Right.

MS. RODGERS: Well, and the issue of, you know, to whom you send the notice, I mean, there was talk with Tommy, about, you know, a registry where you -- you know, financial institutions registered with whoever service of process was. There was talk about, you know, some of the institutions in the state now are required to appoint the secretary of state as their agent for service of process, and -- but there's not -- there's not a simple way to go about it. There's no way to maintain a registry of addresses and who the mortgage servicers are and the lenders are and --

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MR. BARRETT: What if we limited the tax lien lenders recovery to their financial position and required that any additional funds be returned to Fred's people? In other words, if you bought a tax lien for $500 --

MR. BAGGETT: Wait, wait, wait. We're legislating now. We're not a legislature, we're not a court.

MR. BARRETT: It's just a question, Mike.

MR. BAGGETT: We've got rules people can live by. I understand your issues are -- where you're coming from, but I don't think we have the power to do that.

MR. BARRETT: I think that's coming, though.

MR. BAGGETT: Well, that's fine. Get these two ladies to go talk for you in the next session. Okay. So your issue is, part of it is, how do we get service on the lienholders that works --

MS. RODGERS: Right.

MR. BAGGETT: -- and same kind of issue we have with --

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MS. RODGERS: Same issues.

MR. BAGGETT: Yeah.

MS. RODGERS: And I assume what would work on the home equity loans would probably work with us.

MR. BAGGETT: Okay. Well, judges that don't want Marvin Zindler -- although, I understand he's now dead, so you-all are safe.

MR. BARRETT: I've had Marvin. That's no fun.

MR. BAGGETT: Marvin or his successors, you know, how are we going to deal with this one, too. Really it's the same issue, is it not?

MR. BASTIAN: It is the same issue.

MR. BARRETT: Yeah.

MR. TEMPLE: It really is.

MR. BARRETT: I'm certainly sympathetic with the position it puts them in, because obviously facts don't sell newspapers, and these reporters are rarely interested in the --

MR. BAGGETT: Yeah.

MR. BARRETT: -- eccentricities of the statute and truly understand the judge's role, so there is no question that the judge is being put in a bad spot.

MR. BAGGETT: Right.

MR. BARRETT: The Legislature did that and

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then flicked this thing on the Court here, and we're kind of the instrument of that infliction, but it's sure a bad spot for the judge.
MR. BAGGETT: So whatever we come up with that's applicable to both of these issues is what we're going to get to live with, I guess, right?
MS. RODGERS: Mary, do you see any difference between -- you know, from the standpoint of whether the notice on tax lien foreclosures and those sorts of things, any reason why it should be different from what we're dealing with with regard to notice on the home equity?
MS. DOGGETT: I haven't yet.
MS. RODGERS: Yeah.
MS. DOGGETT: So, no.
MR. BAGGETT: Okay. Is there anything else that we need to be doing with respect to tax liens that would be unique other than --
MS. NEELEY: Yeah. There's some unique requirements in the statute as to what goes into them, the notice, the application, et cetera, so it spells it out in some fairly significant detail.
MR. BAGGETT: So we're going to have a new part of 736.
MR. BASTIAN: Make it 736a, but it's laid

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out one, two, three, four.
MS. NEELEY: It's specified.
MR. BASTIAN: It's pretty clear.
MR. BAGGETT: Okay. All right. We'll just make that (a). Yeah, we can just make it a whole new tax lien deal.
MR. TEMPLE: Mike, I think all that's going to be easier than maybe what it jumps out at some of you initially primarily because Kelly and Mary and Tommy and others negotiated a lot of this during the session.
MR. BAGGETT: Right.
MR. TEMPLE: As Tommy says, it's set out pretty well in Senate Bill 1520, and to kind of pick it up and put it in a rule isn't going to be as difficult as you might initially think.
MR. BAGGETT: Okay.
MS. DOGGETT: I'm going to go out on a limb here and go even further than that. I don't think that the rule needs to be amended to reflect any of the changes that are contained in Senate Bill 1520, because I spoke with the legislative assistants for -- or the general counsel for Wentworth and the former chief of staff for Paxton when the committee -- when this task force was formed and I said, you know, "I don't understand what we're doing here," and that's why I called you, Mike, and

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Tommy.
MR. BAGGETT: And I clearly didn't know. Don't worry about that.
MS. DOGGETT: And you didn't know any more than I did, so -- no. It says that the liens shall be foreclosed in this manner. It doesn't say that they shall be foreclosed "pursuant to." It says -- it was crafted very carefully so that it gives you the tax code provision 32.06(c)(2) says you shall foreclose in this manner, except in -- as modified by these few different parameters, notice shall be longer. I've got a whole list of them right here. I'm trying to paraphrase, but I don't see the need -- and maybe somebody else could explain to me what it is in 736 and 32.06 that conflict and why we need to make a change to that.
MS. NEELEY: Well, the content is totally different in terms of the application.
MS. DOGGETT: But do you see what I'm saying, Karen? It doesn't say --
MS. NEELEY: Yeah.
MS. DOGGETT: -- "shall foreclose pursuant to." It says "this is manner that's already set up in the law." You follow that.
MS. NEELEY: Yeah. (c)(1) says what the application has to say.

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MS. DOGGETT: Right.
MS. NEELEY: And the application in 736 has a different content. It's easy to do.
MR. BASTIAN: Yeah, it's easy to do.
MR. BAGGETT: I think you just put that all into 736.
MS. NEELEY: It's easy. You just do a cut and paste of (c)(1) into 736 as the content of the application, boom, it's done.
MS. DOGGETT: As you said, a separate provision in 736 --
MS. NEELEY: Yeah.
MS. DOGGETT: -- as opposed to applying 32.06 to law.
MS. NEELEY: Yeah, because otherwise you've got the wrong content in your application.
MR. BASTIAN: And I have a practical comment to that, because you see it in the home equity line of credit that's not in the Constitution. If you don't put it in that rule, you would be amazed how many people don't even know what you're talking about. You need to put it in the rule, because right now a lot of people will go foreclose a home equity line of credit. Because they didn't see the word "home equity line of credit" in 736 they don't even think they have to go get a court order.

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So it's just a practical thing, just put it there so everybody sees it because all you're going to do is just have a bunch of wrongful foreclosures on your hands because somebody didn't bother to go look at the new provision in 36.05 or 36.065. It's too easy it seems to me. Just put it there so it's there and then you don't have to --

MR. BAGGETT: Take what you've agreed to, move it in there, and move on.

MS. NEELEY: Yeah, it's a cut and paste.

HONORABLE BRUCE PRIDDY: I mean, actually, I mean, the rule does give the option, "in the manner provided by" --

MS. NEELEY: Yeah.

HONORABLE BRUCE PRIDDY: -- "law for foreclosure of tax liens or in the manner" -- "or under Rule 736." We can just -- if we don't amend the rule they can't do a 736 for a tax lien, and we can just cut that out, but I think we have to amend the rule to get tax lien foreclosures under 736.

MR. BAGGETT: Right, so we just use the substance that they already have and put it in there.

HONORABLE PHIL JOHNSON: If I might just say something, there may be a concern about taking a statutory provision and putting it into the rule because next time

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they meet over there, they change the statute, and then we've got the rule, and that's the worst of all worlds. You know, they're changing, and we've got to come back, but we talk about bad foreclosures.

MR. BAGGETT: Right.

HONORABLE PHIL JOHNSON: That's going to be a concern that I can see instead of simply referencing in the rule, referencing whatever it is that they do over at the leg., because you just -- somebody may take a one-page bill, just a cleanup item, and all of the sudden now we've got people following the rules that won't go read the statute, so I think that may well be a concern that we ought to think about.

MS. NEELEY: That's a good point, but the problem is (c)(1) says that your application for this order must allege the lien as an ad valorem tax lien, state that they don't want a home equity foreclosure, state that they provided notice, et cetera, et cetera, and confirm that the property owner has not requested deferral of taxes. So there's four elements, and they're totally different from the elements in the application, so it either needs to be --

MR. BAGGETT: Yeah, take one of them.

MS. NEELEY: -- something that says -- to me, I think Tommy is right. And you're both right, if you

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don't put it in the rule somebody is going to leave out an element. If you cross-reference the statute and the statute changes, you've taken care of the elements. It's just going to be a matter of monitoring to make sure it's fixed.

HONORABLE PHIL JOHNSON: You know, we do have in the Rule of Civil Procedures, you know, an affidavit for introducing records, this will suffice, you know, and we don't have a rule. We just say if it's so-and-so, well, this is going to be good enough. Instead of saying it's got to be this way, it says if you do it this way it will be good enough, so maybe somehow, somehow. I guess I'm just a little jumpy --

MR. BASTIAN: Some language that says --

HONORABLE PHIL JOHNSON: Exactly. I'm just a little jumpy about having a rule and then having the Legislature change it on us.

MS. NEELEY: They would never do that.

MR. BAGGETT: But when they go to change it, I mean, part of it they've got to look at the rule. They can direct us again to modify the rule, because what they've done is they've told us to do it under 736.

HONORABLE BRUCE PRIDDY: A clause, "except as otherwise provided by law" might --

MS. NEELEY: Yeah.

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HONORABLE BRUCE PRIDDY: -- solve that.

MR. BAGGETT: I understand your point, but they shouldn't have told us to put it in the rule to begin with if that's the case. We've got to figure out what to do.

HONORABLE PHIL JOHNSON: It's just a concern.

MR. BAGGETT: Yeah, that's fair.

MR. REDDING: Well, could you just reference it and then say "or as may be amended from time to time" and said -- you know, "said procedure be done in accordance with then current law" or something like that, just add on a phrase to the back end of it?

MR. BAGGETT: Okay. We can take a stab at that one. That one shouldn't be too hard to at least start the stab.

Here's what I want you-all to do, too, those of you who are particularly interested in an area, I think you've got e-mails on there, let me know which -- we're going to have at least two subcommittees. One is going to be the cleanup of 735 and 736, and the second one will be the tax lien deal, which probably they'll kind of overlap some, but that's fine. And let me know which ones you want to be on if you want to be on one. We've got to get this done by December 31, so subcommittees, if you want to

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be on one, you've got to -- you've got to be flexible with time and get it done, because we've got to get it done and then have another meeting to make sure everybody is okay with it.

HONORABLE PHIL JOHNSON: Let me say this, the Court wanted it December 31st because, as we understood, this needs to be done, and it needs to be done for the industry, and that's our concern, but we want to make sure it's done right.

MR. BAGGETT: Yeah, because right now what do they do if we don't have the rule, and they've got to file a lawsuit, I guess, and do it judicially in the interim, but anyway, we'll see. Okay. Other issues that we may or may not have? Anybody got? Tommy, you got any other issues?

MR. BASTIAN: Huh-uh.

MR. BAGGETT: You've got to be kidding me. We're all love and affection. Manny.

MR. NEWBURGER: I'm going to raise one, but I'm not sure we can or should deal with this, but my client base is lawyers all over the country are under attack, and one of the biggest forms of attack is upon the litigation privilege. The lawyers who follow the rules ought to get to follow the rules and not get sued for doing it. Is there any way we can put something in here

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to make it clear that the litigation privilege under Texas common law is intended to apply to proceedings under these rules?

MR. BAGGETT: I think your first statement was right. We're probably beyond what we can do with that.

MR. NEWBURGER: I had to ask, because in Florida it's foreclosure firms, and it had to go all the way to the Florida Supreme Court. There's a case, Cole vs. Echevarria, just decided earlier this year that had to go all the way up there at a cost of hundreds of thousands of dollars to get the state Supreme Court to decide whether litigation privilege applied to their proceedings to foreclose mortgages, and I would really hate to see that process clog up the Texas courts if there were a way to put it in the rule.

MR. BAGGETT: Makes sense. I think that's a probably bigger issue for the overall rules committee whenever they're doing rules. If they want to get into that, they can do that. That's when Marvin is going to come in and say, "This is lawyers writing rules to protect lawyers. This is ridiculous."

HONORABLE PHIL JOHNSON: Let me talk to you about that, Manny. We're working through some disciplinary rules stuff right now, so why don't you visit

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with me after this?

MR. NEWBURGER: Thank you.

MR. BAGGETT: Did you have something, Mike?

MR. BARRETT: Well, I wasn't sure whether you were saying "forever hold your peace."

MR. BAGGETT: No, no.

MR. BARRETT: Tommy, do you want to hold forth on the judges that are ruling that the provisions in the deed of trust -- why don't you explain that? You're much more scholarly than I.

MR. BASTIAN: Well, as you know, in our Rule 736 proceeding it's not appealable, but there are judges that just kind of -- just like there are lawyers, just like there is borrowers that go out, you know, kind of way out there, and I think we need to put something in the rule that you have the ability to do a mandamus on these, and that would be kind of the check and balance on some judges. I mean, I've got some orders here where judges are actually reading the deed of trust and having their own interpretations and then going and denying the order, and you know, that's way out there, that I think there needs to be some -- I don't know how you -- and there's no check and balance on that. They can just --

MR. BARRETT: Don't we have one judge in Houston that has declared the rules unconstitutional,

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these rules? The way I read this.

MR. BASTIAN: Well, you could --

MR. BARRETT: She's inviting a declaratory judgment action to determine whether or not she's right, but she thinks that the internal language of the Fannie Mae deed of trust and the rules are self-cancelling and that the rules themselves impose unconstitutional obligations, so --

MR. BAGGETT: The rules aren't constitutional?

MR. BARRETT: Yeah.

HONORABLE BRUCE PRIDDY: Under a Federal like due process or under 750?

MR. BARRETT: Yeah, they're due process. She says the deed of trust creates -- or the statute -- or the Constitution that provided nonrecourse status for home equity loans prevailed and that there are provisions about the rules that in her mind apply recourse and, therefore, are unconstitutional.

MR. BASTIAN: The best we can figure out, what she's saying is that, as you know, a substitute trustee's deed, the warranties of title come from the borrower and because the borrower has to give warranty of titles in that substitute trustee's deed then that's a violation of the Texas Constitution that says you can't

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ask of anything from the borrower other than the property. I mean, that's the best we can figure out her order, what she's saying, but right now you can't do anything about it. You have a choice. You can either --

MR. BARRETT: We've got 70 orders stacked up in her court that she won't sign because the rules are unconstitutional, so I think we should probably try to do something about clarifying whether the fact that the rules conflict with recourse provisions in the Constitution.

MR. BAGGETT: I don't think we can do that in the rules. "This is a real rule, and you better live by it."

MS. NEELEY: And we mean it.

MR. BARRETT: You said raise the issue.

MR. BAGGETT: I understand.

MR. BARRETT: I'm raising the issue.

MR. BAGGETT: I'm glad you raised it. That would be my suggestion, mandamus.

MR. BASTIAN: But see, mandamus, these are unappealable, so I mean, we've gone around and around, and what we ended up doing, we just did judicial foreclosures, but now we have a record, so that then we can go do -- but, you know, that's almost, wait a minute, that's a whole lot to have to go through.

HONORABLE BRUCE PRIDDY: I don't think there

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is anything that would prevent a -- Doggett and I were talking. I don't think there is anything that would prevent a mandamus. You ought to do it. You ought to do it and see, because I've always assumed that you can mandamus these.

MR. BARRETT: I agree. I don't think we need to change the rule to create --

HONORABLE BRUCE PRIDDY: But if you mandamus and the court of appeals says you can't mandamus because of the nonappealability provision then we can change the rule, but let's get a court of appeals --

MR. BARRETT: Yeah. All right.

MR. BAGGETT: Any other issues we've got, other than lunch?

MS. RODGERS: I have a question. Where did the nonappealability come from? It's not in the Constitution.

MS. NEELEY: Yeah.

MR. BAGGETT: No, it's not.

MS. RODGERS: Where did you-all come up with that?

MR. BAGGETT: How did we do it? How did we do it?

MR. BASTIAN: Well, because it was either up or down.

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MS. RODGERS: Okay.

MR. BASTIAN: And we've tried to preserve the law like it's always been, that if you had a complaint, well, then you go file your lawsuit and then that abated it.

MS. RODGERS: Okay.

MR. BAGGETT: See, with the rules that we have you don't have normal discovery and all that stuff, so what we did is we said here's another way that you can do everything. So you don't want to be appealing something that just gives you an order while you should be litigating it over in a court, and you have a right to do that that stops all this. I mean, you don't want them going on simultaneously.

MS. RODGERS: Right.

MR. BAGGETT: And you have a right to stop all that stuff and tee it up in a regular case.

MR. BASTIAN: Rule 736 was designed for those cases where nobody filed a response or didn't care so it wouldn't clog up the system.

MS. RODGERS: Right.

MR. BASTIAN: That's its purpose.

MS. NEELEY: Yeah, exactly.

MR. BAGGETT: And we really were thinking about the courts and what kind of burden it would be, and

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if we got a whole bunch of these, if half their docket were these cases, that would not be good, so how do we balance all of that to make it work.

MR. BASTIAN: What a lot of people forget is most of the pundits were saying you had to go do a judicial foreclosure on these things. Man, lordy mercy.

MR. NEWBURGER: This was actually a very important trade-off because without this rule you would have to go out, as I always used to have to do, and get a restraining order to stop a foreclosure.

MR. BAGGETT: Right.

MR. NEWBURGER: And what this did was this gave any consumer who wanted to raise a dispute the ability to stop it merely by filing a lawsuit. So this was a win-win deal.

MR. BAGGETT: Yeah.

MR. NEWBURGER: Folks in Mike's business, unopposed, uncontested foreclosures were streamlined and didn't clog the courts. It was a win for consumers because we went from a cumbersome process of seeking a restraining order and a temporary injunction to simply having to file a suit and be able to accomplish the same thing.

MR. BAGGETT: Yeah. Our biggest issue is we patterned it after Colorado law, and we figured that

somebody in Texas would say, "We don't follow anything in Colorado, we do our own thing." So anyway.

Okay, I'm glad there are no other issues. I need to go get lunch for you guys and see where the heck it is, and I want to thank all of you for coming, and we'll get two committees, and let me know which one you want to be on, and we'll go down the road.

(Meeting adjourned.)

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REPORTER'S CERTIFICATION
MEETING OF THE
TASK FORCE ON JUDICIAL FORECLOSURE RULES

* *

I, D'LOIS L. JONES, Certified Shorthand Reporter, State of Texas, hereby certify that I reported the above meeting of the Supreme Court Advisory Committee on the 7th day of November, 2007, and the same was thereafter reduced to computer transcription by me.

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Given under my hand and seal of office on this the _____ day of _____, 2007.

_____
D'LOIS L. JONES, CSR
Certification No. 4546
Certificate Expires 12/31/2008
3215 F.M. 1339
Kingsbury, Texas 78638
(512) 751-2618

#DJ-198

IN THE SUPREME COURT OF TEXAS

Misc. Docket No. 07-9160

ORDER CREATING TASK FORCE ON JUDICIAL FORECLOSURE RULES

ORDERED that:

The Texas Legislature has twice directed the Supreme Court to promulgate rules of civil procedure for the judicial foreclosure of home equity loans and reverse mortgage loans. *See* Orders in Misc. Docket No. 99-9233 (referencing Tex. S.J. Res. 12, 76th Leg., R.S. (1999)) and Misc. Docket No. 97-9231 (referencing Tex. H.J. Res. 31, 75th Leg., R.S. (1997)). In response, the Court promptly promulgated Rules 735 and 736, Texas Rules of Civil Procedure. Recent legislative enactments, however, appear to warrant further review of the procedures established in those rules.

Therefore, the Court is appointing a Task Force on Judicial Foreclosure Rules to review Rule 735 and Rule 736 and to present to the Court any recommended amendments to those rules.

The Court appoints the following individuals to the Task Force:

Hon. James A. Baker
Hughes & Luce
1717 Main St., Ste. 2800
Dallas, Texas 75201

Hon. Bruce Priddy
116th District Court
600 Commerce, 6th Floor
Dallas, Texas 75202-4606

Hon. Mark Davidson
11th District Court
201 Caroline; 9th Floor
Houston, Texas 77002-0000

Hon. Amalia Rodriguez-Mendoza
Travis County District Clerk
P.O. Box 1748
Austin, Texas 78767-1748

W. Mike Baggett
Winstead, Sechrest & Minick
5400 Renaissance Tower
1201 Elm Street
Dallas, Texas 75270-2199

Michael C. Barrett
Barrett Burke Wilson Castle Daffin & Frappier, L.L.P.
15000 Surveyor Blvd, #100
Addison, Texas 75001

Tommy Bastian
Barrett Burke Wilson Castle Daffin & Frappier, L.L.P.
15000 Surveyor Blvd, #100
Addison, Texas 75001

Mary Doggett
Harrison-Doggett, L.L.P.
Locust Street Professional Building
206 East Locust Street, Suite 214
San Antonio, Texas 78212

Fred Fuchs
Texas Rio Grande Legal Aid
4920 North IH-35
Austin, Texas 78751

Linda Kellum
Coordinator, 88th District Court
300 Monroe St., P.O. Box 607
Kountze, Texas 77625-0607

Bill Kramer
2626 Howell St., 10th Floor
Dallas, Texas 75204-4064

Thomas A. T. McRae
C.H. Guenther & Son, Inc.
P.O. Box 118
San Antonio, Texas 78291

Tom Morgan
Texas Association of Realtors
1115 San Jacinto Blvd., Suite 200
Austin, Texas 78701-1906

Karen M. Neeley
Cox Smith Matthews, Inc.
111 Congress, Suite 2800
Austin, Texas 78701

Mannie Newburger
Barron, Newburger, Sinsley & Wier, PLLC
1212 Guadalupe, Ste. 102
Austin, Texas 78701

Tim Redding
Regional Underwriting Counsel
First American Title Insurance Company
1500 South Dairy Ashford, Suite 300
Houston, TX 77077-3858

Kelly S. Rodgers
919 Congress Ave., Suite 1165
Austin, Texas 78701

Larry Temple
Temple & Temple
400 West 15th Street, Suite 1510
Austin, Texas 78701

Mr. Baggett will chair the Task Force. Justice Johnson will serve as the Court's liaison. The members serve at the pleasure of the Court. The Task Force should meet as soon as practicable and should make a final report to the Court on or before December 31, 2007.

SO ORDERED, in Chambers, this 20th day of September, 2007.

Wallace B. Jefferson, Chief Justice

Nathan L. Hecht, Justice

Harriet O'Neill, Justice

J. Dale Wainwright, Justice

Scott Brister, Justice

David M. Medina, Justice

Paul W. Green, Justice

Phil Johnson, Justice

Don R. Willett, Justice

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841 F.2d 592

96 A.L.R.Fed. 895, 5 UCC Rep.Serv.2d 1392

UNITED STATES of America, Plaintiff-Appellee,
v.
HIBERNIA NATIONAL BANK, Defendant-Third-Party Plaintiff Appellant-Cross- Appellee,
v.
Joseph M. RAULT, Jr., Third-Party Defendant-Appellee-Cross-Appellant.

No. 86-3774.

**United States Court of Appeals,
Fifth Circuit.**

April 5, 1988.
Rehearing and Rehearing En Banc Denied May 9, 1988.

Clarnece F. Favret, III, Favret, Favret, Demarest & Russo, New Orleans, La., for Hibernia Nat. Bank.

Joseph M. Rault, Jr., New Orleans, La., pro se.

Virginia Patton Prugh, Robert J. Ashbaugh, Washington, D.C., for U.S.

Appeals from the United States District Court for the Eastern District of Louisiana.

Before CLARK, Chief Judge, REAVLEY, Circuit Judge, and HUNTER,* District Judge.

EDWIN F. HUNTER, Jr., District Judge:

Hibernia National Bank appeals the district court's judgment which held that Hibernia is liable to the United States for $220,000. Cross-appellant Joseph Rault appeals the district court's judgment that he is liable to Hibernia for $110,000. The case was briefed and argued and we now affirm the judgment for the United States against Hibernia, but vacate and remand the judgment for Hibernia against Rault.

I.

During 1982 the United States Army contracted with Rault Center Hotel of New Orleans for the hotel to provide lodging to new Army recruits. In the latter part of that year the hotel billed the Army for $24,844.50 for services rendered pursuant to the contract. On December 23, 1982, the Army issued a Treasury check to the hotel which contained two different figures. In the center or body of the check the amount to be paid is typed: " * * * 24844 DOLLARS/50 CENTS." On the right side of the check appears the amount of "$244844.50." The conflicting figures on the check went undetected by the Army.

On December 27, 1982, a hotel employee presented the check to Hibernia National Bank accompanied by a deposit slip for $24,844.50. Hibernia accepted the deposit

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and credited the hotel account for the amount listed on the deposit slip. The check was then forwarded for processing to the Hibernia operations center. In the operations center all checks are read by proof operators and are then "magnetic ink computer readable" (MICR) encoded which designates the amount of the check and other routing information. MICR encoding allows the check to be read by high-speed automated readers. The check was handled by Hibernia proof operator Monica Green. She apparently entered both the amount of the deposit ($24,844.50) in the proof machine and the amount of the right hand side of the check ($244844.50). As a result, an out of balance condition was created and the proofing machine signaled a $220,000 error.

Looking only at the deposit slip and the figure on the right side of the check, Monica Green determined that the error was the customer's, and prepared a penciled correction slip indicating a $220,000 credit which she sent to the corrections clerk. She did not bring the problem to the attention of a supervisor. Una Poree, the "Corrections Clerk," prepared a typed credit memo from Monica's penciled copy.

The district court found that when hotel employee Herman Taylor received the customer credit notice, he informed a Hibernia employee that the hotel account was credited for $220,000 more than the deposit. James Peterson, Herman Taylor's supervisor, testified that he also advised Hibernia of the overcredit in late December 1982. The overcredit to the hotel account was not adjusted.

Hibernia did not look into the situation despite the initial notification by Taylor and the follow-up telephone call placed by Peterson. Hibernia did not contact the Army, the Treasury Department, or the Federal Reserve Bank, but transferred the Treasury check with an accompanying letter to the New Orleans Branch of the Federal Reserve. Hibernia was given immediate provisional credit by the New Orleans Branch for the $244,844.50 shown on the cash letter. The Treasury check was then transferred to the Federal Reserve Bank of Atlanta where the check was read using an MICR reader. The check, a photo of the check, and the Federal Reserves accounting record of the transaction were then sent to the Treasury for final examination in January 1983.

It generally takes the Treasury six months to reconcile check payment data with drawn checks. Where there is an overpayment on a Treasury check, the Treasury issues an adjustment to the Federal Reserve Bank, which debits the account of the depository bank and sends the depository bank a copy of the adjustment. In the present case, for no known reason, the Treasury did not issue an adjustment.

Hibernia permitted the Rault Hotel to draw against the $244,844.50 deposit almost immediately. By August 31, 1983 the amount on deposit was $102,475.87. In September of 1983 Hibernia permitted Rault to withdraw $100,000 to be used for the purchase of a certificate of deposit in another institution.

In August 1983 the Army Finance Office received notice of a possible overpayment. In February 1984, the Army Finance Office received a copy of the check and noticed the overpayment. The United States demanded repayment of the $220,000 from the hotel and Hibernia; both parties refused these demands.

The United States filed suit alleging that Hibernia National Bank and Rault Petroleum Corporation, which wholly owned Rault Center Hotel, converted the $220,000

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overpayment on the Treasury check. Hibernia filed a cross-claim against Rault Petroleum Corporation for fraud and a third-party negligence claim against the United States and the Federal Reserve Bank. Hibernia also filed a third-party claim against Joseph Rault individually alleging that he fraudulently converted the proceeds of the Treasury check. Rault Petroleum Corporation was placed in involuntary bankruptcy and all proceedings against the corporation have been stayed.

The district court held that the Treasury check was a valid $24,844.50 check, and that Hibernia failed to exercise ordinary care by processing the check for $244,844.50. Judgment was entered in favor of the United States and against Hibernia for $220,000.[1] Judgment was also entered for Hibernia and against Joseph Rault for $110,000.

II.

United States v. Hibernia National Bank

Hibernia first contends that the district court erred by applying federal law to the claim against it, insisting that state law rather than federal law controls.

It is well that "[t]he rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law." Clearfield Trust Co. v. United States, 318 U.S. 363, 366-68, 63 S.Ct. 573, 87 L.Ed. 838 (1943). In Bynum v. FMC Corp., 770 F.2d 556, 568 (5th Cir.1985), this Court states that federal common law must be applied where the application of state law would frustrate federal policies or interfere with the United States' duties or authority, the "most obvious example" being "a controversy whose outcome would have an immediate effect on the federal treasury." Because the application of federal law is intended to further federal policies it is immaterial that a particular federal statute is not applicable.

The district court found that Herman Taylor of Rault Center Hotel notified Hibernia of the overpayment in late December 1982, and thus Hibernia had actual notice of the overpayment. Hibernia contends this finding is clearly erroneous because Hibernia employees testified that they did not remember Taylor or any other hotel employee advising them of the overcredit, and because of the large amount involved they would have remembered if they had been advised of the overcredit.

A finding is "clearly erroneous" under Fed.R.Civ.P. 52 when "although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948). "[W]hen a trial judges' finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error." Anderson v. City of Bessemer City, 470 U.S. 564, 575, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985). The district court's finding that the hotel gave actual notice of the over-credit to Hibernia is not clearly erroneous.

Section 4-202(1) of the Uniform Commercial Code (West 1977) imposes on all banks a duty of ordinary care in forwarding checks it accepts for collection. The trial court, after reviewing all the evidence, expressly concluded that Hibernia breached its duty.

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The rationale for this conclusion is emphasized by the trial court's specific findings. (footnote 1, supra)

Hibernia argues that the routine and customary banking practice is to encode deposited checks for the amount on the right of the check, rather than the amount in the body. They insist that there was no breach of duty on its part because "the check was paid according to the instructions of its maker--the Army--for the amount of $244,844.50." which appeared on the right of the check. Section 3-118(c) of the U.C.C. provides that "[w]ords control figures except that if the words are ambiguous figures control." Though the Treasury check does not state an amount expressed in words, the district court held, and we assuredly agree that the figure in the body of the check, in the place customarily reserved for words, is the controlling amount.[2] H. Bailey & R. Hagedon, Brady on Bank Checks Sec. 3.17 at 3-19 (5th ed. Supp.1986). Hibernia's reliance on commercial custom is misplaced. Commercial custom does not apply where the U.C.C. provides otherwise. See U.C.C. Sec. 1-103; also U.C.C. Sec. 3-104, Official Comment 2 ("[A] writing cannot be made a negotiable instrument within this Article by contract or by conduct.") Moreover, it would be inequitable to apply the banking industry's unilateral "custom" to a maker, such as the Army, that is unaware of or may not recognize such a custom.[3]

Hibernia next asserts that its actions only caused an over-credit to be placed in the hotel's checking account, and that the loss was caused by Joseph Rault's fraudulent depletion of the account which was an intervening superceding cause of the loss and not foreseeable by Hibernia. This argument is spurious. Hibernia's mistake in overcrediting the hotel's account made Rault's depletion of the account possible, thus Rault's use of the funds was not "intervening." Furthermore, it is foreseeable that when a bank overcredits a customer's account, and the customer advises the bank of the overcredit but the bank fails to act, the customer may conceivably deplete the account.

Hibernia contends that the United States was negligent because the Army completed the check with conflicting figures and neither the Federal Reserve or the Treasury noticed the error. They insist that the trial court erred by failing to apply comparative negligence principles and failing to apportion liability. Comparative fault principles are not generally applicable to commercial transactions. See Bradford Trust Co. v. Texas American Bank-Houston, 790 F.2d 407, 409 (5th Cir.1986). The transactional analysis of the U.C.C. places liability on the party that is in the best position to guard against the mistake which gives rise to the loss. United States Fidelity and Guaranty Company v. Federal Reserve Bank of New York, 620 F.Supp. 361, 369-70 & n. 14 (S.D.N.Y.1985), aff'd, 786 F.2d 77 (2d Cir.1986). In the present case the bank was not only in the prime position to remedy the mistake, but by improperly encoding the check was the cause of the mistake. The erroneous encoding made it possible for the overpayment to be made; therefore they should plausibly bear the loss. H. Bailey & R. Hagedon, Brady on Bank Checks Sec. 15.25 at 15-55 (5th ed. 1979). Hibernia asserts that the Government's delay contributed to the loss. However, on this record it cannot be determined to what extent the Government's delay was due to the misencoded check. In that context, we reiterate that Hibernia had immediate notice of the error and failed to act. See United States v. National Bank of Commerce in New Orleans, 438 F.2d 809, 812-13 (5th Cir.), cert. denied, 404 U.S. 828, 92 S.Ct. 64, 30

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L.Ed.2d 57 (1971).

Uniform Commercial Code Sec. 4-213(1) provides that "[u]pon final payment ... the payor bank shall be accountable for the amount of the item" Hibernia would have this court to hold that the "final payment" rule prevents the Government's recovery. This position is utterly without support. Under U.C.C. Sec. 4-213(1) the Treasury is accountable for the "amount of the item" which is $24,844.50; this sum has been paid and is not at issue. The final payment rule under most circumstances bars recovery on the instrument. The Government's action is for the amount in excess of the instrument. It follows that recovery is not precluded by the final payment rule. This suit is predicated on Hibernia's negligence[4] (by encoding the check for $244,844.50) and breach of quasi-contract, resulting in the conversion of $220,000 of Treasury funds. The Government's suit for return of its Treasury funds is not an action on the instrument. Recovery is not prevented by final payment on the instrument. See e.g. United States v. National Bank of Commerce in New Orleans, 438 F.2d 809.

We affirm the judgment in favor of the United States against Hibernia. This is the end of the matter.III.

Hibernia National Bank v. Joseph Rault

We recognize the difficulties faced by the district judge on this facet of this litigation. We quote from his findings:

11) During the period of December, 1982 until September 1983, Rault Petroleum Corporation, through its representatives, spent the monies comprising the overpayment in the 1111 Operations Account to the detriment of Hibernia.

12) Joseph Rault, Jr. had knowledge of the source of the $220,000 credit and was aware that it was due to an overpayment on the Treasury check. He failed to advise Hibernia of the discrepancy in the 1111 Operations Account though he was regularly advised and, indeed, knew of the excess balance in the account certainly as early as March 4, 1983. The balance in the account on March 31, 1983 was $139,138.18.

13) Notwithstanding his certain knowledge of the overpayment, Joseph Rault, Jr. took no action to escrow, or instruct any of his employees to escrow the funds left in the account as a result of the overpayment. Joseph Rault, Jr. never delegated responsibility to any other officer, or employee of Rault Petroleum Corporation to inform Hibernia of the continuing overcredit but did take action to transfer those funds to other account which accrued to his personal financial benefit." (Record Excerpt, p. 1886)

17) The actions of Rault Petroleum Corporation and Joseph Rault, Jr. in transferring funds comprising the overpayment and depleting the 1111 Operations Account, was the cause in fact of the loss.

22) Fraud is a misrepresentation or a suppression of the truth made with the intention to either obtain an unjust advantage or to cause a loss. A corporate officer's failure to escrow monies which he knows were paid to the corporation by mistake is a non-dischargeable conversion, constituting fraud. Lawrence Freight Lines, Inc. v. Transport Clearings-Midwest, Inc., 16 B.R. 890 (B.C.W.D.Missouri 1979)". (Record

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Excerpt, p. 1889-1890)

23) Joseph Rault, Jr. is responsible to Hibernia for reimbursement on an amount not yet specifically determined by the Court.

Subsequently, a judgment was signed holding Rault liable to the bank for $110,000 one-half of the overcredit funds and one-half of the judgment cast against the bank of $220,000. Both Hibernia and Rault note that no reasons were noted for the amount of the judgment. There is an absence of any indication of how, why or on what basis the trial court rendered judgment for $110,000. It appears to us that the only theories of law which could explain the one-half award are first, that Rault was personally comparatively half at fault in causing the loss. There are no findings consistent with this theory. Second, that when Rault first had a clear picture of the funds in the account; he had a personal duty to escrow these funds for the bank. Under this theory, the court would have had to conclude that the amount left in the account at that time was $110,000.

Prudence dictates that this Court not endeavor to review the judgment against Rault without knowing what theory, i.e. negligence or fraud, he was held liable under and without knowing the reasons for the amount of the judgment. That task, in the first instance, is best left to district court, which is free to invite additional briefing and/or argument if deemed appropriate, and to alter its findings and conclusions on this facet of the case if deemed appropriate.

The judgment in favor of Hibernia and against Rault is vacated and remanded for further considerations in accordance with this opinion.

AFFIRMED IN PART AND VACATED IN PART AND REMANDED.

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*

District Judge of the Western District of Louisiana, sitting by designation

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1

The district judge entered specific conclusions as to Hibernia's fault:

3) Hibernia National Bank owes the United States a federal common law duty to exercise good faith and ordinary care in the handling of United States Treasury checks. U.C.C. Sec. 4-103(1); Bullitt County Bank v. Publishers Printing Co., 684 S.W.2d 289 (Ky.Ct.App.1984); Charles Ragusa & Son v. Community State Bank, 360 So.2d 231 (La.App. 1st Cir.1978).

6) Hibernia breached its duty to exercise ordinary care when, presented with a check containing conflicting figures, it failed to contact the payor to ascertain the correct amount before negotiating the check. McCook County National Bank v. Compton, 558 F.2d 871 (8th Cir.), cert. denied, 434 U.S. 905, 98 S.Ct. 302, 54 L.Ed.2d 191 (1977).

7) Hibernia breached its duty to exercise ordinary care by failing to inform the Federal Reserve Bank concerning the discrepancy on the face of the check.

8) Hibernia further breached its duty to exercise ordinary care when it incorrectly IMCR encoded the amount payable on the check. It also breached its duty by failing to follow reasonable instructions of its customer as to the correct amount.

10) Hibernia breached its duty to exercise ordinary care when its proof operator, acting in accordance with Hibernia policy failed to reconcile the amount of the deposit slip with

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the amount in the body on the instrument once alerted to a discrepancy when the proofing machine went out of balance.

11) Hibernia breached its duty to exercise ordinary care when it failed to investigate the overpayment subsequent to notification by Herman Taylor and James Peterson.

13) Hibernia's failure to exercise ordinary care was the proximate cause of the loss suffered by the United States in the amount of $220,000.00.

16) Since Hibernia's failure to exercise ordinary care was the proximate cause of the loss suffered by the United States, Hibernia is liable for the $220,000.00 overpayment. Hibernia, however, did not act in bad faith with regard to its actions.

2

Hibernia also argues that the district court erred by applying U.C.C. Sec. 3-118(c) because the check does not state an amount in words and the figures are ambiguous. Hibernia's argument is self-defeating. Either the check is a valid $24,844.50 check, or the document is non-negotiable because it does not state a "sum certain." U.C.C. Sec. 3-104(1)(b). In either event Hibernia failed to exercise ordinary care when the item was processed as a $244,844.50 check

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3

The district court, without assigning reasons, struck the testimony of Hibernia's expert witness James Stone who testified that banks routinely proof only the figure on the right of the check. Hibernia contends that Stone qualified as a witness and the district court erred. Because the banking industry's unilateral custom is immaterial, the district court's error, if any, in striking Stone's testimony was harmless

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We emphasize our total agreement with the trial courts conclusion that Hibernia "did not act in bad faith with regard to its actions."

FannieMae
3900 Wisconsin Avenue, NW
Washington, DC 20016-2892

Announcement 06-24 ***December 7, 2006***

Amends these Guides: Servicing

Process for Foreclosing on Mortgage Loans Reflecting Mortgage Electronic Registration Systems, Inc. as Mortgagee

This Announcement describes our new policy related to foreclosure actions for mortgages in which Mortgage Electronic Registration Systems, Inc. ("MERS") is the mortgagee of record. These changes are effective immediately for any foreclosure action initiated on or after publication of this Announcement.

Judicial Foreclosure

Servicing Guide Part VIII, Section 105, Conduct of Foreclosure Proceedings

Effective immediately, MERS must not be named as a plaintiff in any judicial action filed to foreclose on a mortgage owned or securitized by Fannie Mae. MERS is the mortgagee of record when either a mortgage names MERS as the original mortgagee and is recorded in the applicable land records, or a completed and recorded assignment names MERS as the mortgage assignee. Therefore, in most jurisdictions, the servicer will need to prepare a mortgage assignment from MERS to the servicer, and then bring the foreclosure in its own name, unless the Servicing Guide requires that the foreclosure be brought in the name of Fannie Mae. In that event, the assignment will need to be from MERS to Fannie Mae.

The assignment from MERS to the servicer should be in recordable form (*e.g.*, executed and notarized) and, in some jurisdictions, it will need to be recorded. In other jurisdictions, it may be held by the servicer or the foreclosure attorney without being recorded. Because the assignment will be completed before the foreclosure begins (and recorded if required by applicable law), MERS will no longer be the mortgagee. Therefore, MERS should not be named as a plaintiff in the foreclosure complaint or other judicial filings.

The servicer should consult its foreclosure attorney to determine the specific legal requirements of each jurisdiction in which it conducts judicial foreclosures of mortgage loans in which MERS is the mortgagee of record.

Non-Judicial Foreclosure

In any non-judicial foreclosure proceedings, the servicer has the option of either assigning the mortgage from MERS to the servicer (in accordance with the process outlined above for judicial foreclosures), or proceeding with the foreclosure with MERS as the mortgagee of record.

If MERS remains the mortgagee of record, the servicer must ensure that the foreclosure attorney or trustee accurately identifies the status of MERS. MERS may never be identified as the "owner" or the "holder" of the Note or Security Instrument being foreclosed. MERS may be identified as the beneficiary of the deed of trust being foreclosed, but only if MERS is also identified as a nominee for the servicer, or as a nominee for Fannie Mae if our Servicing Guide requires the foreclosure to be brought in Fannie Mae's name.

The servicer should consult with its foreclosure attorney or trustee to determine the specific legal requirements of each jurisdiction in which it conducts non-judicial foreclosures of mortgages in which MERS is the mortgagee of record. Further, if MERS remains the mortgagee of record, then the servicer should also consult with its foreclosure attorney or trustee to determine the appropriate manner for identifying MERS' interest in the subject mortgage.

In any event, if an assignment has been recorded from MERS to either the servicer or Fannie Mae, and the borrower reinstates the mortgage prior to completion of the foreclosure proceedings, the servicer may choose to re-assign the mortgage to MERS and re-register the mortgage with MERS. Any such action will be at the discretion and expense of the servicer.

Servicing Guide, Part VIII, Section 108.03, Other Reimbursable Expenses
Fannie Mae will not reimburse the servicer for any expense incurred in preparing or recording an assignment of the mortgage from MERS to the servicer or Fannie Mae, as applicable.

Servicing Guide, Part VIII, Section 202.03, Foreclosure Conducted in MERS' Name
The provisions in Servicing Guide Part VIII, Section 202.03, addressing conveyance of properties when the foreclosure was conducted in the name of MERS, will continue to apply to any non-judicial foreclosure action completed in accordance with this Announcement and in which MERS remains the mortgagee of record.

****

Servicers should contact their Portfolio Manager or Servicing Consultant if they have any questions about the information addressed in this Announcement.

Pamela S. Johnson
Senior Vice President

Administration favors keeping exemptions to e-signature requirements

By Maureen Sirhal *National Journal's Technology Daily* July 3, 2003

The Bush administration is calling on Congress to continue exempting an array of documents from a law that gives legal weight to e-signatures.

The National Telecommunications and Information Administration urged Congress in a report issued Monday to retain current exemptions from the Electronic Signatures In Global E-Commerce (ESIGN) Act, which allows transactions such as mortgages to be completed entirely electronically.

The 2000 law exempted documents in nine categories: court records; wills and testaments; domestic and family law records; contracts governed by state commercial law; cancellation notices for utility services; cancellation notices for health or life insurance benefits; property foreclosures, evictions and default notices; product-recall notices; and shipping papers for hazardous materials and dangerous goods.

Those exemptions were included to allow lawmakers, as well as industry and consumer groups, to study the impact of e-signatures in those areas. Congress called on NTIA to conduct a three-year evaluation of the law to determine whether those areas should continue to be excused.

After collecting comments and studying the issue for nearly a year, the agency said it is too early to eliminate the nine exemptions to ESIGN. NTIA suggested that while the use of e-signatures has been growing, today's technology is not adequate enough to guard the confidentiality of the most sensitive documents, so Congress should not eliminate the exemptions.

The agency noted that in several of the categories, states are the primary governing entities and have enacted exemptions to their own e-signature laws for documents such as wills, court testimonies and family law papers. The elimination of some of the ESIGN exemptions could lead to inadvertent disclosures of information that is otherwise considered highly sensitive and confidential in some states, the report noted.

"After three years," the report said, "there has been remarkable progress in some of the areas covered by the exceptions in terms of the use of electronic signatures and records. ... Due to the high confidentiality and privacy interests inherent in transactions involving other exceptions (such as wills, family law, foreclosure and defaults, utility cancellations), there are few, if any, solutions other than ESIGN that institutions and the marketplace can provide at this time."

Moreover, NTIA found, "policies and practices for consumer protection in each area are still being established and incorporated into e-commerce and market systems."

The agency's recommendations incorporate advice that it received from various experts and industry groups that supported retaining the nine exemptions. They include trade associations for banks, mortgage lenders, financial services firms and lawyers.

POST A COMMENT

To post a comment, you must provide a name and a valid e-mail address. Messages must be limited to 400 words. By using this Service you agree not to post material that is obscene, harassing, defamatory, or otherwise objectionable. Although *Government Executive* does not monitor comments posted to this site (and has no obligation to), it reserves the right to delete, edit, or move any material that it deems to be in violation of this rule.

Story: Administration favors keeping exemptions to e-signature requirements

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Articles from other issues of Probate and Property

Technology

Property

Technology Property Editor: Gerald J. Hoenig, 8495 Caney Creek Landing, Alpharetta, GA 30005, ghoenig@mindspring.com.**Guest Editors:** Keith H. Mullen and James R. Nowlin III, Winstead Sechrest & Minick P.C., 5400 Renaissance Tower, 1201 Elm Street, Dallas, TX 75270-2199. Contact Mullen at kmullen@winstead.com or Nowlin at jnowlin@winstead.com.

Technology—Property provides information on current technology and microcomputer software of interest in the real property area. The editors of *Probate & Property* welcome information and suggestions from readers.

eChange Is Our Friend: The eMortgage

Information technology has clearly changed many aspects of our personal and professional lives. In the way we shop, communicate, travel, recreate, entertain, and even vote, information technology touches and affects every aspect of daily life. It (or "IT") has radically altered the manner in which lawyers work and deliver services to clients. Indeed, the scope and pace of that change seems to be accelerating. Changing information technology is more than a friend: for better or for worse, it is now a constant companion.

The reach of information technology, of course, extends into the commercial real estate finance industry. Within the industry, information is no longer collected, analyzed, and shared using labor-intensive, paper-based tools. The migration of valuable information from paper to an electronic medium has allowed real property to compete and be traded on an equal footing with traditional investments in companies selling goods and services. Indeed, it is increasingly clear that information technology has become the backbone of the thriving commercial mortgage-backed securities industry (CMBS), which now claims over 25% of all commercial real estate mortgages in the United States. For the first time, commercial real estate debt is a publicly traded commodity.

This sea change will soon transform the medium for documenting real estate loans from paper to electronic (the "eMortgage"). The eMortgage is "a mortgage where the critical loan documentation—specifically the promissory note, assignments and security instruments—are created electronically, transferred electronically and ultimately stored electronically." This definition is from Mortgage Industry Standards Maintenance Organization (MISMO), *Glossary of Terms*, Version 1.1, and is available at www.mismo.org. The eMortgage is not a scanned-in document image. Instead, it is a specific electronic file of the security instrument package that is consented to, recorded, assigned, and stored electronically. In essence, the eMortgage is the electronic embodiment or manifestation of the security instrument. The "hard" or "wet ink" closing binder is transformed into electronic dots and dashes. The development of the

eMortgage will change the manner in which all parties to real estate loan transactions conduct business.

A Changing Industry

The real estate finance industry is hard at work changing over to paperless electronic transactions. The real estate industry understands that an electronic process results in faster and more accurate sharing of information during the underwriting, closing, servicing, and secondary market phases of real estate lending. A faster closing process, in turn, allows loan pricing to be more accurate and responsive to secondary market pricing. Other processing benefits include reduced duplication of tasks and less documentation. In addition, risk is reduced because quality control and regulatory compliance can be performed electronically during the life of the loan. By reducing operational inefficiencies, costs are lowered and liquidity is increased, with the result being increased competitiveness if not higher profitability. Furthermore, with an increase in the quantity and quality of information available to investors, the value (or price) of the product (the loan) to the investors will be more easily determined, reducing the discount for uncertainty. On a broader scale, lenders are investigating technologies such as business process management, rules engines (which automate decision making through a process), and electronic document and content management (all processes that leverage the benefits of a paperless process) to make the next technological leap in improving lending operations. The industry focus is about becoming leaner, faster, and smarter, with the added benefit of transparency for investors, rating agencies, and regulators. With this purpose in mind, the company with the best process and the best information wins. Accordingly, Douglas Duncan, the chief economist of the Mortgage Bankers Association, notes that “technology is altering the structure, products and processes of the U.S. real estate finance system.”

Industry views the eMortgage as a key component in going paperless. The eMortgage will change the process of closing and selling loans, the means by which loan information is collected, and the scope of information available to investors. Understanding the eMortgage will ease the transition to a paperless process. Undoubtedly, the eMortgage will be a positive and fundamental change in a real estate lawyer’s professional life.

Legal Framework for Change: UETA and ESIGN

It is no surprise that a change of this magnitude requires significant adjustments in both the basic legal underpinnings and the terms describing them. Some of the important terms include:

This “new” language empowers us to start understanding the eMortgage.

Conceptually, the eMortgage touches on the core or basic elements of creating contracts. The first step in the process of providing uniform rules to govern electronic transactions was the passage in 1999 of the Uniform Electronic Transactions Act (UETA) by the National Conference of Commissioners on Uniform State Laws (NCCUSL). See Uniform Electronic Transactions Act (1999), which is available at www.ncsl.org/programs/lis/
CIP/ueta.htm. Generally, UETA’s objective is to allow electronic transactions to be just as enforceable as transactions memorialized on paper with “wet ink” signatures.

UETA § 7 contains several basic rules supporting electronic commerce: (1) a signature (or a record) “may not be denied legal effect or enforceability under state law solely because it is in electronic form”; (2) the effect or enforceability of a contract may not be attacked “solely because an electronic record was used in its formation”; (3) any legal requirement for a writing will be satisfied by an electronic record; and (4) an electronic signature will satisfy any legal signature requirement.

UETA § 16 introduces the concept of “transferable records.” Other sections of UETA identify notes and associated documents as transferable records when in electronic form. Generally, promissory notes may be negotiable, which turns in part on whether the note is the single, unique embodiment of the obligations and rights in the note. UETA addresses this need for the “unique token” quality of the electronic note and establishes that a transferable record exists when there is a single authoritative copy of the record (existing and unaltered) in the “control” of a person. Under UETA
§ 16(d), this “control” person is a “holder” for purposes of transferring or negotiating that record under the Uniform Commercial Code.

Specifically, UETA applies only to transactions in which the parties agree to conduct the transaction in an electronic format. UETA is intended to be content neutral, leaving unchanged the substantive rules of law and leaving open the technology for verification of the integrity or identity of the documents.

After the introduction of UETA, almost every state (and the District of Columbia) adopted its own version of UETA. Not surprisingly, some states also included non-uniform provisions, or established new regulatory overlays. These state provisions, and the slow pace of state adoption, undermined a basic premise of electronic commerce: uniformity. Consequently, in June 2000, Congress enacted the Electronic Signatures in Global and National Commerce Act (ESIGN), which addresses the use of electronic records and signatures in interstate and foreign commerce. See Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, 114 Stat. 464, which is available at www.ftc.gov/os/2001/06/esign7.htm.

Just as with UETA, ESIGN is an overlay statute that is intended to be content neutral and points to a general objective of ensuring the validity and legal effect of electronic contracts. ESIGN supersedes local law in a state that does not implement UETA. In states that have enacted a uniform version of UETA, the provisions of ESIGN may be superseded in whole or in part. Under ESIGN, an electronic signature cannot be denied solely because it is in an electronic form. Generally, many provisions of ESIGN are similar (or even identical) to provisions in UETA. (Note that ESIGN imposes special requirements on parties in the context of consumer protection laws (from a desire to preserve laws governing consumers' rights to receive certain information in writing)). Taken together, UETA and ESIGN provide the legal ladder for the climb up to the eMortgage.

Key Concepts: Consent and Control

Under both UETA and ESIGN, a party to a commercial loan must expressly agree to the use of electronic records and signatures. This agreement must expressly permit the treatment of an electronic record as a "transferable record." Perhaps most importantly for a lender desiring to sell a loan, UETA and ESIGN give the purchaser of an eMortgage rights and defenses analogous to those of a "holder" or a "holder in due course" under the Uniform Commercial Code based on the concept of "control" of the transferable (electronic) record.

Both UETA and ESIGN list safe harbor requirements for a showing of "control," which can be summarized as follows:

• A single, "authoritative" copy of the transferable record, which is unique, identifiable, and unalterable (with limited exceptions) must exist.

• The authoritative copy identifies the person asserting control as the person to whom the record was issued (or the person to whom the record was most recently transferred).

• The authoritative copy is communicated to and maintained by the person asserting control (or its designated custodian).

• Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control.

• Each copy of the authoritative copy (and any copy of a copy) is readily identifiable as a copy that is not the authoritative copy; and

• any revision of the authoritative copy is readily identifiable as an authorized (or unauthorized) revision.

With UETA and ESIGN in place, electronic signatures are equivalent to paper or "wet" signatures. Accordingly, the legal foundation for the eMortgage has been laid.

Change Agents in the Neighborhood

New laws and a changed legal framework are not a magic formula for the implementation of the eMortgage. Note that the eMortgage is more than simply changing, with the wave of a technology wand or the push of a keyboard button, a pile of paper contained in a closing binder into strings of dots and dashes that can be viewed on your computer screen, and even printed if needed. The eMortgage is a change from a paper-driven process to an electronic process. Conceptually, this change fundamentally

alters the role of every player in the mortgage lending industry—and requires consideration of a countless number of different business practices, legal issues, and technologies. A thoughtful glance at the real estate industry reveals that the “advance” agents for the eMortgage are at work, focusing on the “low hanging” fruit, on “hybrid” approaches, or on pursuing important preliminary tasks.

eRecording and eNotarization

In 2004, NCCUSL proposed the Uniform Real Property Electronic Recording Act (URPERA), which attempts to resolve questions relating to the roles of UETA and ESIGN in the states’ real property recording functions. See Uniform Real Property Electronic Recording Act, which is available at www.law.upenn.edu/bll/ulc/urpera/URPERA_Final_\Apr05-1.htm. The goal of URPERA is to create legislation authorizing real property records officials to begin accepting and storing electronic records and to develop systems for searching and retrieving electronic records. Many states have already adopted this model statute, and even separate electronic recording statutes that provide for acceptance of electronic documents (including images) for recording.

URPERA also addresses the issue of the stamp and seal requirements for notaries—it states that the notary is not required to affix a “wet” stamp and seal. Although URPERA § 5 mandates that a statewide body develop data standards and other standards that are needed for electronic recording, currently no eRecording and eNotarization standards exist at the state level. Industry organizations like the Standards and Procedures for Electronic Records and Signatures (SPeRS, www.spers.org), Property Records Industry Association (PRIA, www.pria.us), and the Electronic Financial Services Council (EFSC, www.efscouncil.org) are, however, working on these issues and related concerns such as document security.

MISMO

The Mortgage Industry Standards Maintenance Organization (MISMO, www.mismo.org) is a nonprofit organization founded in 1999 by the Mortgage Bankers Association. MISMO is dedicated to developing, promoting, and maintaining electronic procedures and standards for the mortgage industry and has published an “eMortgage Guide” to shape the eMortgage effort. As part of its work, MISMO has developed a “Logistical Data Dictionary” that contains over 3,500 unique data elements, names, or tags for real estate information used in the real estate lending industry. This organization is “staffed” by numerous volunteers (with a very small staff of paid employees), who even today are working diligently to develop voluntary guidelines, specifications, and XML (platform neutral) data standards and other related tasks—all with the goal of effectuating data exchange and the eMortgage.

MISMO work groups currently are focusing on and implementing a wide range of tasks, including

- loan servicing transfers,
- the XML version of the CMSA-IRP,
- Superset Chart of Accounts (which is fundamental to creating standards),
- Electronic Third Party Reports,
- digital signature requirements for commercial entities,
- commercial loan document index,
- eMortgage Closing Guide,
- eMortgage Guide,
- MERS commercial note eRegistry, and
- government housing workgroups.

In addition, MISMO has created the “SMART” document, which is specifically designed to create a single electronic file for representing mortgage information using open standard technologies. This specification is a technical framework for representing documents in an electronic format, which links data, the visual representation of the form, and electronic signatures. The SMART document has numerous benefits and improvements for compliance, disclosures, delivery, and recording functions for commercial mortgage loans. MISMO lists the following opportunities and benefits:

The benefits and advantages of the SMART document are that it has different layers or categories of security. Its fundamental attributes and appearance are illustrated on page 57.

Note that while MISMO plays an important role in the eMortgage movement, numerous other influential industry organizations also are focusing on implementing the eMortgage. Some of the organizations include: Mortgage Bankers Association (which founded MISMO), www.mortgagebankers.org; United States Notary Association, www.enotary.org; National Notary Association, www.nationalnotary.org; Property Records Industry Association, www.pria.us; Mortgage Electronic Registration Systems, Inc., www.mersinc.org; National Conference of State Legislatures, www.ncsl.org; Standards and Procedures for Electronic Records and Signatures, www.spers.org; Secure Identity Services Accreditation Corporation, www.sisac.org; Appraisal Institute, www.appraisalinstitute.org; Commercial Mortgage Securities Association, www.cmbs.org; National Association of Realtors, www.realtor.org; Fannie Mae, www.fanniemae.com; Freddie Mac, www.freddiemac.com; American Land Title Association, www.alta.org; and Electronic Financial Services Council, www.efscouncil.org.

MERS, Fannie Mae, and Freddie Mac

Tangible steps toward implementing the eMortgage have been taken in several other industry sectors. Mortgage Electronic Registration Systems, Inc. (MERS) acts as a clearinghouse for tracking the ownership of mortgages in the secondary market. The MERS registry (or “eRegistry”) is built on the ESIGN safe harbor requirements discussed above. MERS tracks and conclusively establishes at a given time the “controller” of an eNote and the location of the “authoritative copy.” In so doing, since 1997, more than 30 million residential mortgage loans have been registered, with more than 24,000 loans registered daily. The eRegistry for commercial mortgage notes became operational in 2003 and is being used at an accelerated pace by influential commercial mortgage lenders.

Fannie May has been accepting a limited number of eMortgages since July 2000, when it purchased two home loans in a purely paperless process. (Even the deeds were paperless.) Since then, Fannie Mae has been working with numerous lenders and technology vendors to pilot eMortgages. The eMortgage is a focal point for Fannie Mae, which has released version 2.0 of its *eMortgage Guide,* which is available at www.efanniemae.com (search using the term “emortgage” for the “eMortgage Delivery” page). Several lenders already are realizing some of the benefits of the eMortgage. For example, Navy Federal Credit Union (Vienna, Virginia) currently is using electronic signatures to close loans and is one of the dozens of lenders selling electronic loans to Fannie Mae.

In addition, Freddie Mac is committed to the eMortgage and, like Fannie Mae, is an active member in industry organizations like MISMO, MERS, SPeRS, and EFSC. Freddie Mac has issued both its eMortgage handbook and a timeline to assist the industry in understanding its requirements for originating, delivering, and servicing eMortgages that Freddie Mac will purchase. Note that the Freddie Mac eMortgage handbook and timeline are available at www.freddiemac.com (search using the term “emortgage” for the handbook and search using the phrase “emortgage timeline” for the eMortgage timeline). Indeed, both Fannie Mae and Freddie Mac have promulgated provisions for the eNote in their respective uniform instruments.

The Beginning of the End

But does the residential eMortgage movement and experience have any relevance to the commercial mortgage industry? True, certain aspects of residential mortgage lending are markedly different from commercial mortgage lending. Recall, however, that residential mortgage-backed securitization (MBS) furnished the template for implementing CMBS in the commercial mortgage lending industry. For background information, see Peter M. Carrozzo, *Marketing the American Mortgage: The Emergency Home Finance Act of 1970, Standardization and the Secondary Market Revolution*, 39 Real Prop. Prob. & Tr. J. 765 (2005). Accordingly, CMBS has forever changed commercial mortgage lending. Add in the desire of Wall Street for quality data, the powerful drive for transparency (based on Sarbanes-Oxley), and the benefits of an electronic process and products as described above, and what you can see is the imminent end of the paper commercial mortgage. The beginning of the commercial eMortgage is here and here to stay.

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March 19, 2003

Josephine Scarlett, Attorney
Office of the Chief Counsel
National Telecommunications and Information Administration
14th Street and Constitution Ave. NW
Washington DC 20230

Dear Ms. Scarlett:

These comments are submitted on behalf of the ABA Business Law Section, Committee on the Uniform Commercial Code in response to the request for comments(1) on whether the Uniform Commercial Code Exception in the Electronic Signatures in Global and National Commerce Act should be retained.

The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the policy of the American Bar Association.

I. Introduction

The Electronic Signatures in Global and National Commerce Act (codified at 15 U.S.C. § 7001 et seq) ("Esign") provides that the "provisions of Section 7001 of this title shall not apply to a contract or other record to the extent it is governed by. . . . the Uniform Commercial Code, as in effect in any State, other than sections 1-107 and 1-206 and Articles 2 and 2A." 15 U.S.C. § 7003.

This exclusion from the provisions of Section 7001 for contracts or records subject to the Uniform Commercial Code should be maintained. The Uniform Commercial Code as in effect and as revised accommodates electronic commerce in a carefully considered manner. Section 7001 is not necessary to facilitate electronic commerce in these transactions, and would be potentially harmful to established and evolving paper-based and electronic commercial transactions which are governed by the Uniform Commercial Code.

II. Facilitation of electronic transactions

The thrust of Section 7001 is to eliminate barriers to electronic commerce erected by rules of law that require records, signatures, or contracts to be in writing.(2) Contrary to the assertion of the Request for Comments, the Uniform Commercial Code has been carefully adapted to allow for electronic commerce in the transactions to which it applies.

Uniform Commercial Code Article 1 provides general principles and definitions that are applicable to transactions covered by other Articles of the Uniform Commercial Code. To the extent that Article 1 contains a writing requirement in Sections 1-107 and 1-206, those provisions are **not excluded** from the provisions of Section 7001. In 2001, both the American Law Institute and the National Conference of Commissioners on Uniform State Laws approved a revision of Article 1. The revision fully accommodates electronic commerce by eliminating writing requirements and revising key definitions to allow for electronic communications.(3)

Uniform Commercial Code Article 2 covers sales of goods and **Article 2A** covers leases of goods. Under Esign Section 7003, transactions covered by Articles 2 and 2A are **not excluded** from the provisions of Section 7001. Thus the provisions of Section 7001 apply to contracts for the sale and lease of goods.(4)

Uniform Commercial Code Article 3 governs negotiable instruments, including checks and promissory notes. Negotiable instruments must be in writing and signed. To the extent that parties want to engage in electronic payment mechanisms, Article 3 does not prevent parties from doing so. Thus parties may use funds transfer, debit cards, credit cards, ACH transactions or other forms of electronic payment mechanisms. All of those other types of payment mechanisms are governed by law other than Article 3 and Article 3 does not prevent their use. Article 3 provisions would

merely not apply to those electronic payment mechanisms.

The primary purpose of Article 3 is to provide for the rights of third parties who take the negotiable instrument. Article 3 is premised on a regime of possession and indorsement of an instrument and the rights and obligations that accompany that possession and indorsement. To allow for electronic negotiable instruments there must be a concept that is the functional equivalent to possession and indorsement in order to adequately protect third party rights. The difficulty in making such a wholesale change was recognized at the time that both the Uniform Electronic Transactions Act (UETA) and Esign were promulgated by setting up the concept of a "control" system to substitute for the possession and indorsement concept as it applies to electronic notes. UETA Section 16 and Esign Section 7021. Nothing has changed to make that concern less real. Adequately protecting third party rights and assuring commercial market stability cannot be done by two party contracts in the absence of a statutory scheme that is designed to accommodate electronic negotiable instruments. Applying Section 7001 provisions would sweep away the writing and signature barriers as applied to the creation and enforcement of a negotiable instrument. This change would create havoc as there would be substitute for the possession and indorsement concepts that currently govern the rights and obligations of third parties as to a negotiable instrument.(5)

Uniform Commercial Code Article 4 governs collection of "items" through the banking system. "Items" include negotiable instruments but also include promises or orders that may not be negotiable instruments. As with Article 3, the rules concerning the rights and obligations of the banks and their customers are written with the concept of possession of the "item" in mind. At the time Article 4 was revised in 1990, the question of using electronic means for the collection of items was contemplated and provision was made for electronic presentment if agreed to by the parties.(6) A bank and its customer may also agree to provide for electronic collection of items that were originally put into the banking system in paper form.(7) Absent those agreements, however, applying the rules of Article 4 to the collection of non-paper items would create great uncertainty about the rights and liabilities of the banks in the banking process.

Uniform Commercial Code Article 4A governs funds transfers through payment orders in the banking system. Payment orders need not be in writing but may be issued electronically. (8) The provisions of Section 7001 which validate electronic transactions are thus unnecessary as it relates to transactions governed by Article 4A.

Uniform Commercial Code Article 5 governs letters of credit. Article 5 authorizes letters of credit to be in any form agreed to by the parties, including electronic form. Presentations under a letter of credit may be in electronic form if so agreed to by the parties. The provisions of Section 7001 that validate electronic records and contracts are thus unnecessary in letter of credit transactions governed by Article 5.

Uniform Commercial Code Article 6 governs bulk transfers and requires notice to creditors of a transferor in a bulk transfer which is sale of a substantial part of an inventory seller's inventory. Forty two states have repealed Article 6. For those very few states retaining old Article 6 or enacting a revised version of Article 6, the transferee of the bulk transfer must give written notice to the creditors of the transfer or file written notice of the transfer with the applicable state office. This notice requirement is designed to protect creditors of the transferor from dissipation of the transferor's assets. In practice, most transferees will take the route of filing the notice with the applicable state office as the least costly and most efficient route. Whether the state office is equipped to handle electronic filings will determine whether electronic filings are feasible. Thus authorizing the notice to be in electronic form will have little effect on transactions subject to this article.

Uniform Commercial Code Article 7 governs documents of title issued by warehouses and carriers who are in the business of storing and carrying goods for hire. A document of title must be in writing, be issued by or to a bailee, and be treated in the course of business and finance as evidence that the person in possession of the document of title has the right to the goods covered by the document. As with negotiable instruments, the rules regarding documents of title are written for a paper-based system where rights of third parties are determined in part by possession and indorsement of the paper document of title. As with Article 3, the wholesale elimination of the paper requirement without carefully adapting the rules to the context of the electronic environment would create significant disruption of rights of third parties as to the documents and the goods covered by the document. Application of the rules of Section 7001 would cause disruption in the markets that depend upon documents of title by allowing for electronic documents of title without adequate infrastructure. (9)

Uniform Commercial Code Article 8 governs transfers of investment securities. In the revision of Article 8 in 1994, the Article was crafted to allow for both paper-based and electronic-based securities. Rights of third parties are determined in part depending upon the form in which the security is held. Sweeping away the writing requirement as provided in Section 7001 would result in great uncertainty about what set of rules should apply to any given security.

Uniform Commercial Code Article 9 governs secured transactions and was significantly revised in 1999. The revised Article 9 is in effect in all states and the District of Columbia. Revised Article 9 allows for electronic security agreements, electronic financing statements, electronic filing and electronic notices. Subjecting Article 9 to the provisions of Section 7001 designed to do away with the paper requirements is unnecessary to facilitate electronic commerce. In addition, for some collateral types, such as negotiable instruments and documents of title, the ability to perfect and enforce security interests in those items are based in part upon the concept of possession of those tangible items. For other collateral types, such as chattel paper and investment securities, parallel systems of rules have been developed for electronic forms and paper forms of that type of collateral. Applying the provisions of Section 7001 to the paper form would upset the certainty necessary for an efficient system of secured transactions and is not necessary to allow for electronic transactions.

III. Retention of records in electronic form

Section 7001(d) provides that if a law requires records to be retained, the information may be retained in electronic form.

The Uniform Commercial Code has only one requirement of record retention concerning items presented on a customer's account if the items have not been provided to the customer. The statute allows the record to be retained in any form, including electronic form, provided that the customer may obtain copies of the item. UCC § 4-406(b). Thus application of Section 7001 as it relates to record retention is unnecessary.

IV. Consumer protection

Section 7001(c) provides that if a statute requires information to be provided or made available to a consumer in writing, the information may be provided electronically, subject to certain safeguards. This allowance of electronically available information to a consumer is subject to several exceptions including that if a previously existing law expressly requires a record to be provided by a method that requires verification or acknowledgment of receipt, the record may be made available electronically only if the electronic method provides verification or acknowledgment of receipt.

The Uniform Commercial Code has only two provisions which require information to be made available to a consumer in writing. Article 7, Section 7-210(2), provides that in foreclosure of a warehouse lien the consumer must get notice either delivered in person or "sent by registered or certified letter to the last known address of any person to be notified." If the provisions of Section 7001 applied to this requirement, the provisions of Section 7001(c)(2)(B) would preserve the ability to give the notice in writing. Article 9, Section 9-616, requires a written explanation of the calculation of the surplus or deficiency in a consumer-goods transaction (where both the debt and the goods which secure the debt are for personal, family or household purposes.) This provision was adopted as a consumer protection provision given the importance of the information to the consumer and the need to make sure that the consumer was able to get the information. To apply Section 7001 to this provision would thus eliminate an important consumer protection provision.

V. Conclusion

As can be seen from the above comments, the current exclusion for the Uniform Commercial Code from the provisions of Esign Section 7001 should be continued.[(10)] To subject the Uniform Commercial Code to the generalized approach of Section 7001 is in large part unnecessary given the carefully crafted accommodations to electronic commerce already in place and would create much disruption and uncertainty in the transactions governed by the Uniform Commercial Code.

Sincerely,

Linda J. Rusch
Chair, Committee on the Uniform Commercial Code

1. 67 F.R. 78421.

2. Section 7001(a) provides that a signature, contract, or record cannot be denied legal effect, validity or enforceability if in electronic form and that a contract cannot be denied legal effect if an electronic record or signature was used in its formation. This section validates the use of electronic records and signatures in contracting. Section 7001(b) provides that no other rights or obligations of existing law are altered other than the requirement of contracts or records be "written, signed, or in nonelectronic form." Section 7001(b) also provides that, persons, other than governmental agencies, cannot be required to agree to use or accept electronic records or signatures. Section 7001(g) provides that requirements of notarization, acknowledgment or verification can be met if the information required is logically associated or attached to the electronic signature or record. Section 7001(h) recognizes that actions of electronic agents may bind the person to whom the action is legally attributable.

3. Assuming wide spread adoption of Revised Article 1, the reference to Sections 1-107 and 1-206 in Esign Section 7003 will no longer be necessary.

4. The proposed amendments of Articles 2 and 2A are up for final approval before the American Law Institute in May 2003 and have been finally approved by the National Conference of Commissioners on Uniform State Laws in August 2002. These amendments revise both Articles to fully accommodate a parties' choice to form contracts for the sale and lease of goods through electronic means and with electronic agents.

5. The newly approved amendments to Article 3 allow for electronic notices and communications that are required or allowed as it relates to a negotiable instrument but does not authorize electronic negotiable instruments. These amendments were approved the American Law Institute and the National Conference of Commissioners on Uniform State Laws in 2002.

6. Section 4-110.

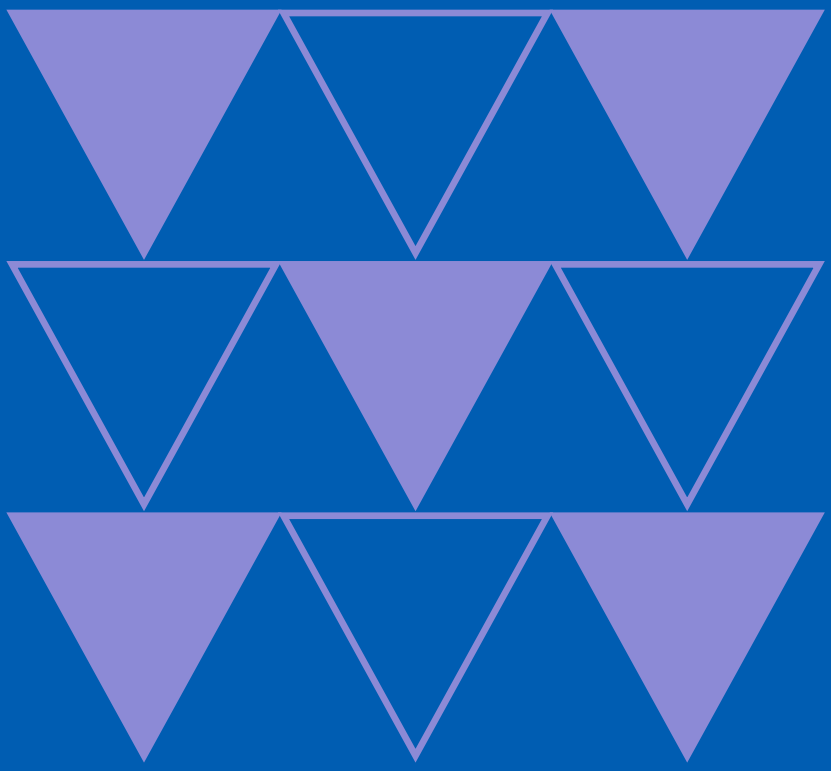
7. Section 4-103 allows for agreements to vary the provisions of Article 4.

8. Article 4A has several provisions in which a writing signed by the customer allows the bank to take advantage of a presumption (commercially reasonable security procedure, 4A-202; proof that a notice was given, 4A-207 and 4A-208). However, other evidence, including electronic notices or agreements would be admissible and sufficient to prove the matter at issue.

9. Article 7 is currently in revision to allow for electronic documents of title and the completion of this project is scheduled for this year, 2003. In allowing for electronic documents of title, the provisions of Article 7 have been revised to provide for a parallel system of treatment for electronic documents with the "control" concept substituting for the paper-based concept of possession and endorsement. The control concept in the proposed revision has been taken from the UETA Section 16 on transferrable records which already facilitates electronic documents of title. Electronic documents of title are also facilitated by the Federal Warehouse Act and regulations pursuant to which the US Department of Agriculture has allowed for electronic warehouse receipts for commodities stored in federally licensed warehouses. The revision to Article 7 is fully compatible with the USDA system.

10. Section 7001(i) states that Esign provisions apply to the business of insurance. Section 7001(j) provides some protection for insurance agents and brokers if there is some deficiency in the electronic procedures agreed to by the parties under a contract. The Uniform Commercial Code has no provisions which govern insurance.

eMortgage Closing Guide



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MISMO eMortgage Workgroup

eMortgage Closing Guide: A guidance paper by the MISMO eMortgage Workgroup

Abstract

This MISMO® eMortgage Closing Guide, published by MISMO®, Inc., a wholly owned subsidiary of the Mortgage Bankers Association, is a mortgage industry reference tool, providing general guidelines for electronic closing platforms and services.

* * * The information provided is educational in nature, providing general information about legal, financial, technological and other considerations associated with eMortgages. It is not intended as legal or other professional advice. You should consult an appropriate professional with any specific questions.

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1 About this guide

1.1 Summary

The MISMO eMortgage Closing Guide, published by the Mortgage Industry Standards Maintenance Organization, Inc. ("MISMO®"), a wholly owned subsidiary of the Mortgage Bankers Association, is a mortgage industry reference tool – a guide to the various aspects of electronic mortgage closing technology and business. MISMO is dedicated to developing, promoting, and maintaining, through an open process, voluntary electronic commerce procedures and standards for the commercial and residential mortgage industries.

1.2 Purpose

The MISMO eMortgage Closing Guide is intended to provide general guidelines for electronic closing platforms and/or services. This guide provides general information about the legal framework surrounding electronic closing implementation. It is educational in nature and is not intended as legal advice. Professional advice should be sought in connection with any specific efforts to implement electronic closing.

1.3 Scope

The MISMO eMortgage Closing Guide describes and explains general electronic closing concepts, definitions, and voluntary guidelines. It is not intended to be a technical implementation guide. It also does not provide information about any specific company's internal processes, patented concepts, business logic, algorithms, or other proprietary details nor is it intended to affect the existing obligations (contractual or otherwise) between business partners. Neither does it provide legal advice. Rather, this guide provides general information about the legal framework surrounding electronic closing implementation. Professional advice should be sought in connection with any specific implementation of electronic closing.

Recommendations contained in this Guide, including those labeled "best practices," are identified as such only as of the time of publication of this Guide. The subject matter of this Guide is subject to rapid change, as is electronic commerce generally and the legislative and regulatory rules that seek to keep up with it.

2 General

2.1 Executive summary

The mortgage industry continues to evolve into an electronic mortgage environment. Since 2001, the mortgage industry has been working cooperatively within the Mortgage Industry Standards Maintenance Organization (MISMO®) to define key processes, transactions, and XML data standards to exchange the mortgage data and documents electronically. This collaborative work led to the formation of a suite of eMortgage concepts and standards that may be used to move forward with eMortgages in the industry.

The closing (or settlement) is the process by which borrowers sign the documents and pay all expenses to take official ownership of their homes. This is a critical event for the borrowers, lenders, closing agents, and other parties in the mortgage transaction. Although the closing process varies from place to place, many activities are standard. One of the standard activities is to sign the documents.

In the electronic closing environment, originators, lenders and title underwriters need to make sure that this electronic transaction is enforceable after the electronic documents are electronically signed and funds are disbursed. There are a number of electronic closing solutions available today. Given the financial significance of the mortgage finance process, industry participants and borrowers will benefit from a standard way to assess whether potential solutions meet minimum compliance requirements.

This guide provides voluntary industry guidelines that may be used to evaluate the platform and/or service that comprises an eMortgage closing solution. The guidelines cover legal, process, and technical aspects of the transaction. The guide also includes supporting overview material and sample processes to connect key concepts, processes, and guidelines across the electronic closing transaction. It is not intended to be a technical implementation guide. It also does not provide information about any specific company's internal processes, patented concepts, business logic, algorithms, or other proprietary details.

Industry adoption is growing because eMortgages reduce time, cost, and risks. MISMO standards are critical to achieve eMortgage adoption across the industry. The eMortgage Closing Guide is one of the key building blocks in the evolution to the complete electronic mortgage environment.

2.2 eClosing overview

Introduction
The closing of an electronic note (eNote), security instrument (eSecurityInstrument), and other electronic closing documents requires the use of a specialized computing platform, generally known as an electronic closing or eClosing system. An electronic closing system is typically a web-based platform that allows the lender, the closing agent and the borrower to electronically review, sign, store and transfer closing documents.

Assumptions
For the purposes of this guide we assume that the closing results minimally with an eNote signed by the borrower. Other closing documents (e.g., security instruments) may or may not be electronically signed.

The electronic closing process may occur at the offices of a lender, trusted settlement agent, in the borrower's home, or at some other acceptable location. Regardless of the location, a notary or signing agent must be present to confirm the identity of the principals (e.g., borrowers, property sellers, etc.).

A title insurer may be involved in conducting the electronic closing or, at a minimum, issuing a title insurance policy. In general, a lender's title insurance policy protects a lender's security interest in the property against loss due to title defects, liens or other matters of public record. It is expected that title insurance will provide this coverage, regardless of whether the loan closing occurs electronically or in paper. Some lenders may wish to supplement title insurance with a "Closing Protection Letter" from the title insurer covering the settlement or title agent's acts or omissions in conducting an electronic closing.[1] In some cases, a title policy is not required by the lender; consequently, the lender should analyze the risks associated with executing notes and other loan documents electronically in the absence of title insurance.

The specific process used for any given electronic closing transaction will vary according to the lender, the product and the electronic closing platform on which the electronic closing is conducted. However, the following key principles apply to all electronic closings:

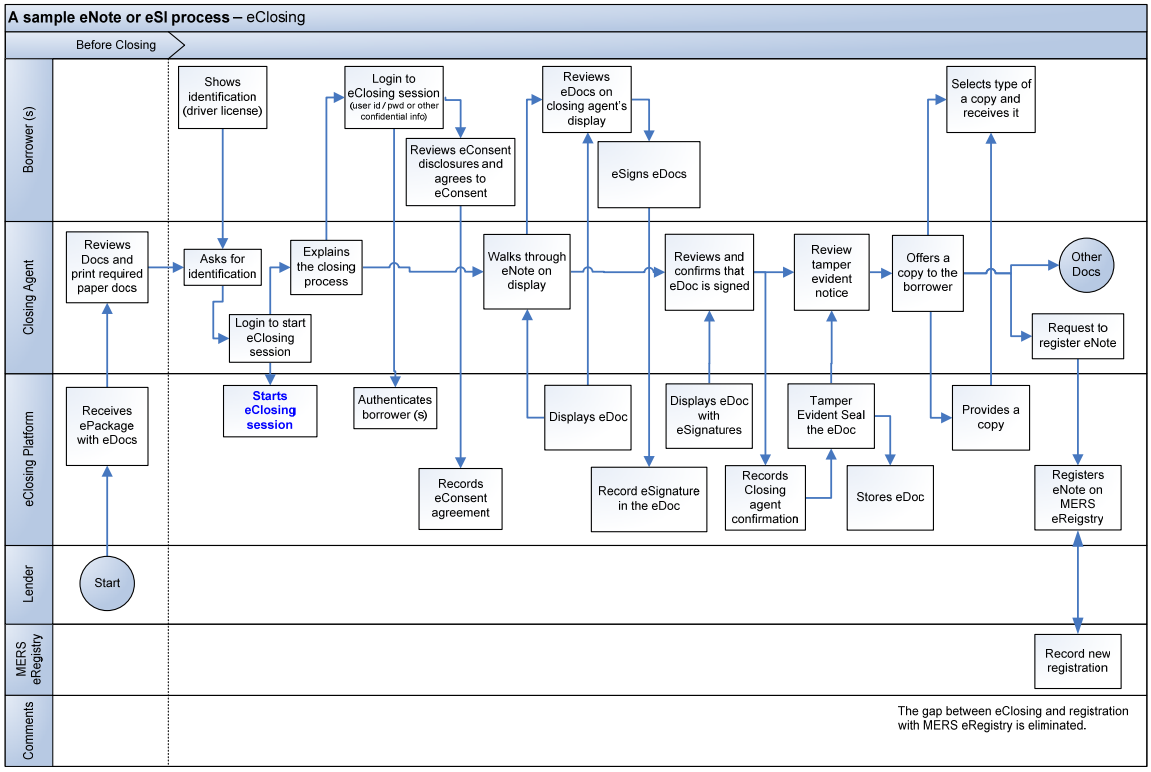
- A notary is present to confirm the identity of the borrower and the capacity and willingness of the borrower to sign documents.
- The process obtains the borrower's consent to sign electronically.
- The eNote and/or eSecurity Instrument and other documents if applicable are electronically signed by the borrower consistent with applicable law.
- The process properly applies a tamper evident signature to the eNote.
- The eNote is registered with the MERS® eRegistry immediately after closing.

[1] Since title insurance coverage varies by policy and closing protection letters may not be available for issuance in every state, lenders should discuss this issue with their title insurers to understand the extent of title insurance and closing protection letter coverage.

- The electronic closing platform maintains a permanent audit trail of all transactions.
- The electronic closing process results in an enforceable eNote.

Process summary

The processes in the mortgage industry vary based on state law, loan product type, lender requirements, investor requirements, and other requirements. The goal of this process summary is to point out common steps that may be involved in a sample electronic closing to support the proposal discussion.



Origination - Closing

- Lender
  - Generates closing docs and delivers them to the closing agent.
- Closing Agent
  - Manages the closing process by having the borrower execute the documents and delivering the recordable documents to the county recorder[2] for recordation.
- County Recorder
  - Records the documents and delivers them back to the lender per instruction.
- Lender

[2] As referenced throughout this Guide, the term "county recorder" is meant to be a generic term for the public or authorized official in the city, county, or other jurisdiction in charge of recording liens or other interests to real property. Such officials are also referred to, for example, as "county clerks," "registrar of deeds," and "recorder of deeds."

- Waits for the trailing recordable documents, receives them, and sends them to a servicer, other lender or investor).
  - Depending on investor requirements, the documents may go to a custodian for a final certification and safekeeping.

Key documents
Real property loans are customarily evidenced by the borrower's signing the loan obligation (the promissory note or promise to pay) and the security instrument (the trust deed or mortgage). Other documents are also required for a mortgage transaction.

Once executed by a borrower, a promissory note represents the legal obligation of the borrower to repay the debt secured by the mortgage. A promissory note that meets certain conditions under Article 3 of the Uniform Commercial Code would be considered negotiable. This allows the mortgage lender to assign the loan upon sale into the secondary mortgage market. The promissory note is the key instrument in the mortgage loan transaction, and if there are conflicts in the provisions of the note and trust deed, the terms of the note are generally controlling. The note is not a recordable instrument.

A security instrument secures the note and evidences the mortgage lender's security interest in the real property. A security instrument may be a "mortgage" or a "deed of trust" or "security trust deed." The security instrument gives a complete legal description of the property securing the loan and provides for foreclosure or conveyance of the property from the borrower (mortgagor) to the lender (mortgagee) in the case of default under the note. A "mortgage" typically requires judicial foreclosure. In general, the security instrument must be properly and timely recorded to protect the priority of the lender's lien on the property.

Other key documents involved in a loan closing may include the following:

- A warranty deed, which conveys title to a property from a seller (grantor) to a buyer (grantee);

- A settlement statement, which provides an itemized listing of the costs and charges that are payable at closing. Items that appear on the statement include real estate commissions, loan fees, points, and initial escrow amounts. HUD provides standard settlement statement forms (e.g., HUD-1 and HUD-1A). The settlement statement is also commonly known as a "closing statement" or "settlement sheet";

- Various disclosures, which are required by federal and state law (e.g. RESPA, TILA, E-SIGN, etc.)

- A power of attorney, which authorizes one individual to act on behalf of another individual (e.g., the borrower).

Conclusion
As discussed above, the electronic closing process shares virtually all the characteristics of a paper-based closing with the exception that key documents can be signed and

retained electronically. However, the enforceability and transferability of the eNote, and the legality of other electronically signed documents depend on whether the closing process and/or system used to create, execute, and store the electronic documents complies with applicable federal and state legal requirements. Additionally, the purchase or investment by secondary market participants in such electronically-created mortgage loans will also depend on whether the closing process and/or system comply with requirements set by the investors.

2.3 Certification overview

Introduction
This eMortgage Closing Guide may be used by interested parties (e.g., auditors, investors, lenders, vendors, etc.) to develop a certification checklist for evaluating eMortgage closing systems or processes. Such a checklist might include the elements required to create, execute, store, and communicate legally enforceable closing package documents (e.g., electronic note, security instrument, etc.). Ideally, the certification checklist would be technology-neutral in order to be a useful tool in evaluating a variety of electronic closing processes and systems.

Process
The certification process used will depend on the requirements of the lender, title insurer and/or the lender's investor. One or more of the following approaches to certifying an electronic closing system or process may be permitted or required:

Level 1 - A self-certification process by a electronic closing system vendor using a certification checklist based on industry guidelines (e.g., information from this Guide, investor requirements, etc.). Completion of the self-certification process could result in a report signed and certified by a senior compliance officer of the eMortgage closing system provider.
Level 2 - An independent and accredited audit and/or qualified law firm certification process using a certification checklist based on industry or other required guidelines. The independent audit would result in a report certified by the audit firm and/or a legal opinion issued by the law firm.
Level 3 - A separate originator, lender, or title underwriter certification process that leverages Level 1 and Level 2 certifications.

Conclusion
The closing package includes the promissory note, security instrument, and other critical mortgage documents. A certification process designed around a certification checklist would provide a consistent way to measure and communicate compliance with legal requirements across the mortgage industry, while still allowing for the protection of proprietary information and the creation of compliant electronic closing systems and processes.

3 Guidelines

3.1 Legal Considerations

Section Outline

I. Introduction
II. General Laws Applicable to Loan Closings
III. Uniform Electronic Transactions Act Summary
IV. ESIGN Summary
V. Authentication (Verification of Identity)
VI. Electronic Signatures and Attribution
VII. Consent Requirements under ESIGN and UETA
VIII. Electronic Format and Delivery of Consumer Disclosures
IX. Summary of the Board of Governors of the Federal Reserve System's (FRB) Interim Final Rules
X. Establishing Control of a Transferable Record
XI. eNotarization
XII. eRecording
XIII. Evidentiary Importance of an Audit Trail
XIV. Data Security
XV. Title Insurance Coverage for eMortgages
XVI. Compliance with ESIGN and UETA Document Retention Requirements
XVII. Conclusion

I. Introduction

This Section of the eMortgage Closing Guide provides a high-level overview of the legal issues associated with the electronic closing of a residential mortgage loan. It both reviews the legal foundation for using electronic documents in mortgage transactions, and highlights some of the key issues that must be addressed for an effective electronic loan closing.

The materials in this chapter are drawn from a number of sources. Readers seeking additional or more detailed information on legal issues related to the use of electronic records and signatures are encouraged to consult the Standards and Procedures for electronic Records and Signatures ("SPeRS"). Portions of this Section are based on the information from SPeRS.

This Section of the eMortgage Closing Guide is published for purposes of education and discussion. It is intended to be informational only and does not constitute legal advice regarding any specific situation, product or service. The use of this Guide is completely voluntary; the Guide's existence does not in any respect preclude anyone, whether that person has approved of the Guide or not, from manufacturing, marketing, purchasing, or using products, processes of procedures not conforming to this Guide. Any person using

this Guide should consult their own legal counsel and/or compliance personnel concerning their particular situation.

II. General Laws Applicable to Loan Closings

There are a multitude of federal and state laws, regulations, and cases that govern and/or influence a typical loan closing event. Although this list is not exhaustive, some examples of loan closing laws include the federal Real Estate Settlement and Procedures Act (RESPA), which provides instructions on how to prepare a HUD-1 settlement statement, the federal Truth in Lending Act, state "wet" or "good funds" laws, state notary laws and witness requirements, and state and local requirements governing real estate document recording. In general, these laws would apply to loan closings, whether conducted with paper documents and ink signatures or electronic documents and signatures. While these loan closing laws provide a baseline to conduct a compliant electronic loan closing, originators, lenders and title insurers will also need to comply with electronic commerce laws that enable an electronic loan closing and, further, the creation of an enforceable electronic mortgage loan transaction.

III. Uniform Electronic Transactions Act Summary

The National Conference of Commissioners on Uniform Laws (NCCUSL)[3] promulgated the Uniform Electronic Transactions Act (UETA) in 1999 as a model act for adoption by the states. UETA represents the first effort at providing uniform rules to govern transactions in electronic commerce. Since UETA's introduction, almost every state, including the District of Columbia, has adopted some version of UETA although some states have included non-uniform provisions.[4] The objective of UETA is to ensure that transactions in the electronic marketplace are as enforceable as transactions memorialized on paper with manual signatures. In general, UETA does not change any of the substantive rules of law that apply to covered transactions. It also does not impose specific technology requirements for verification of identity or the integrity of the document itself.[5] Note that UETA applies only to a transaction in which each party has agreed by some means to conduct electronically.

The basic rules for electronic transactions are found in Section 7 of UETA (Legal Recognition of Electronic Records and Electronic Signatures). To summarize, the fundamental rules are as follows:

- A record or signature may not be denied legal effect or enforceability under state law solely because it is in electronic form;
- A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation;
- Any law that requires "a writing" will be satisfied by an electronic record.
- Any signature requirement in the law will be met if there is an electronic signature.

[3] NCCUSL's model acts can be viewed on their website at www.nccusl.org.

[4] The extent to which these non-uniform provisions are effective is limited by the federal ESIGN Act (see summary below). A detailed discussion of the various state non-uniform provisions and the limitations placed on them by the ESIGN act is beyond the scope of this Guide.

[5] As discussed below, UETA does make some substantive changes to the law concerning the transfer of negotiable debt instruments in an electronic environment.

UETA establishes the concept of "transferable records" in Section 16. An electronic record that would otherwise be a negotiable promissory note under Article 3 (Negotiable Instruments) of the Uniform Commercial Code (UCC) may be a "transferable record" under UETA if agreed by the parties. The "transferable record" concept is significant because the residential mortgage industry relies heavily on negotiable promissory notes to preserve the liquidity of mortgage loans. For a negotiable promissory note executed in paper, the ability to negotiate or transfer the note depends in part upon possession of the original promissory note itself as evidence of the noteholder's exclusive right to enforce and collect the underlying debt. Since it is impossible, in an electronic environment, to "possess" an "original" document, Section 16 of UETA establishes an alternative structure for preserving negotiability.

In general, under Section 16 a person has "control" of a transferable record, meaning the exclusive right to enforce or transfer ownership of the underlying debt obligation (i.e., a "holder" under the UCC), if "a system employed for evidencing the transfer of interests in the transferable record reliably establishes that person as the person to which the transferable record was issued or transferred." Nothing more is required. However, Section 16 also establishes a "safe harbor" for determining that a system for transferring interests in the transferable record is adequate. Under the safe harbor, a transferable record exists when there is a single authoritative copy of that record existing and unalterable in the "control" of a person. For more information on the safe harbor, see the Establishing Control of a Transferable Record Section below.

If a state has enacted UETA, it will be the governing law in the state regarding the enforceability of electronic transactions. Because states may amend UETA as they deem appropriate, state enactment of UETA by itself has not resulted in a national standard for real estate finance professionals to follow. However, the federal Electronic Signatures in Global and National Commerce Act (ESIGN) limits the effectiveness of state amendments to UETA. See the following section for a discussion of how UETA relates to the federal ESIGN legislation.

IV. ESIGN Summary

On June 30, 2000, Congress enacted ESIGN to facilitate the use of electronic records and signatures in interstate and foreign commerce by ensuring the validity and legal effect of contracts entered into electronically. This congressional action reflected concerns over the pace of state enactment of UETA coupled with the ongoing enactment by states of laws either modifying UETA or establishing new regulatory regimes, conditions which prevented the establishment of a uniform national standard. For states that have enacted a uniform version of UETA, the provisions of ESIGN may be superseded in whole or in part. However, non-uniform amendments to UETA that conflict with the main provisions of ESIGN are preempted, for the most part. Also, state regulations that conflict with the requirements of ESIGN are preempted, whether or not the state has enacted UETA.[6] Most of the provisions in ESIGN mirror provisions contained in UETA. However, in order to preserve the underlying consumer protection laws governing consumers' rights

[6] The federal ESIGN Act permits a state to supersede Section 101 of ESIGN with a conforming UETA enactment. Section 104 of ESIGN, which governs state regulation, is not affected by a state's UETA enactment.

to receive certain information in writing, ESIGN imposes special requirements on parties that want to use electronic records. For more information on these requirements, see the Consent Requirements section below.

V. Authentication (Verification of Identity)

"Authentication" is the process used to confirm an individual's identity as a party to a transaction.[7] To ensure enforceability of a mortgage transaction, as well as to minimize the risk of fraud, a lender should ensure that its customers are who they purport to be. In addition, lenders may also be subject to laws requiring authentication of any individual or entity obtaining a loan. For example, the USA Patriot Act and its implementing regulations, which were passed to combat terrorism and money-laundering, require certain financial institutions to verify the identity of any person seeking to open an account and to maintain a record of the information used to verify such person's identity. Further, certain categories of financial institutions, such as national banks, are required by the Patriot Act to adopt written customer identification programs ("CIPs"), which require collection of a customer's name, date of birth, residential or work address for individuals or physical location for legal entities, and a tax identification number (TIN) before the customer can open a deposit or loan account. The information gathered pursuant to the CIP must be verified to the extent reasonable and practicable.

In a traditional loan closing situation, an example of authentication occurs when a signing agent or notary asks to see a person's drivers license or passport to confirm that the person is who he or she purports to be. Generally speaking, authentication of identity in an electronic transaction may occur in two contexts:

- When the relationship between the parties is first created.
- When a transaction occurs in the course of an existing relationship.

In a residential mortgage transaction, authenticating identity when a relationship is first created usually requires reference to some kind of outside source for validation, be it a government-issued ID or verification of ID from another trusted source (e.g., credit bureau, etc.). Authenticating the borrower thereafter over the course of the transaction may rely primarily on a credential issued to the borrower, such as a user ID and password.[8] However, where state law requires applicable mortgage-related documents to be notarized, authentication at the time of notarization in accordance with notarial law will be required.

It is important not to confuse authentication (including notarization) with the act of signing. Authentication involves accurately identifying the parties to a transaction. A signature does not have to provide evidence of the signer's identity, although some types

[7] In this subsection, we are primarily concerned with "authentication" in the context of verifying identity; it should not be confused with other types of authentication, such as authentication of a security agreement in the UCC Revised Article 9 context, "document authentication" performed by a notary to help ensure that documents can be trusted in government or commercial dealings, or the authentication procedure used in litigation for the purposes of admitting certain records into evidence.

[8] The FFIEC has recently advised that certain remote consumer transactions require the use of a two-part authentication process, employing both a password and some other information that is in the consumer's possession, such as a random number generator. At this time, it is not clear that a residential mortgage lending transaction is the type of high risk remote consumer transaction contemplated by the FFIEC guidance.

of signatures may help identify the signer. An authentication process also does not necessarily provide signature attribution or protect an electronic record from alteration, although, once again, some types of authentication will associate a signer with his or her signature and protect a record's integrity. See Subsection VI for a general discussion on Electronic Signatures and Attribution and Subsection XI for a discussion on eNotarization and its relationship to authentication.

The Federal Financial Institutions Examination Council (FFIEC) has published Frequently Asked Questions about the Patriot Act and CIP obligations, as well as a guidance document on "Authentication in an Internet Banking Environment" which is available at www.ffiec.gov. Given these obligations, a lender or originator should ensure that its electronic closing process accommodates the particular customer identification requirements applicable to it. Such an authentication process can occur either technologically within an electronic closing system or through methods traditionally used in paper-based closings. See SPeRS for a general discussion on how an authentication process may be designed to provide evidence of identity and protect a record's integrity.

VI. Electronic Signatures and Attribution

Both ESIGN and UETA similarly define an "electronic signature" as any sound, symbol or process, attached to or logically associated with an electronic record and executed or adopted with the intent to sign the electronic record. Both ESIGN and UETA are intentionally neutral with regard to specifying which electronic signatures would be acceptable in a particular situation. However, lenders should check with their investors for specific guidance on the types of electronic signatures that would be acceptable for use in eMortgages intended to be sold to the such investors. For some examples of different electronic signature types, see Section 3.3 of this Guide.

A Attachment or Logical Association

In a paper-based transaction, the association of a signature to a document is generally shown by such signature being physically affixed to a particular document. However, depending on the circumstances, an electronic signature may be considered valid under ESIGN and UETA even though the signature is not physically viewable on the electronic record itself. For example, a click-through signature process may be a valid electronic signature if designed in such a way that the system logically associates the click signature to a particular electronic record.

B Intent

The validity of an electronic signature requires the intent by the signer to sign and be bound to a particular record. Similar to a paper-based transaction, evidence of intent can be found within the document itself and/or the surrounding circumstances in which the document was signed.

C Attribution of a Signature and Record to a Person

Although ESIGN and UETA provide that electronic signatures are legally equivalent to "wet" ink signatures, attribution remains an issue. Attribution is the process of connecting a particular person to his or her signature on a particular document. For ink signatures, attribution may be done through a handwriting comparison or, in certain

circumstances, through a notary witnessing a person signing a document and acknowledging such act. With the exception of when a notary is present during the signature process, attribution of other electronic signatures may be more complex. UETA provides guidance in this area by stating that an electronic record or electronic signature is attributable to a person if it was the act of the person. An act of a person includes an act done by the agent of a person, as well as an act done by an electronic agent (i.e., computer, signing pad) of a person.

The UETA commentary provides some examples of electronic acts in which the record and signature would be attributable to a person, as follows:

- The person types his/her name as part of an e-mail purchase order;
- The person's employee, pursuant to authority, types the person's name as part of the e-mail purchase order;
- The person's computer, programmed to order goods upon receipt of inventory information within particular parameters, issues a purchase order which includes the person's name, or other identifying information as part of the order.

The act of the person may be shown in any manner, including showing the efficacy of any security procedure applied (i.e., access controls, password and PIN, etc.) to determine the person to which the electronic record or electronic signature was attributable. Furthermore, UETA provides that the effect of an attributed electronic record or signature can be determined from the context and surrounding circumstances at the time of its creation, execution, or adoption, including the parties' agreement, if any, and otherwise provided by law. This means that even if proper attribution occurs, the legal enforceability of such record and signature may still be dependent on other factors (i.e., intent, legal age, capacity, proper authority, etc.).

VII. Consent Requirements under ESIGN and UETA

A. Under ESIGN and UETA, a party must agree to use electronic records and/or signatures with respect to a specific transaction or group of transactions.

Nothing in ESIGN or UETA requires a party to use electronic records and/or electronic signatures in a transaction. In general, the agreement to use electronic records and/or signatures may be either express or implied, and an express agreement may be oral or in writing. However, before a party can electronically provide information to a consumer otherwise required by law to be delivered "in writing", the provisions of ESIGN (and in some cases, the state UETA) require the party to provide specific ESIGN consent disclosures to the consumer, and require the consumer to affirmatively consent to receive the information electronically.

ESIGN requires businesses to obtain from consumers electronic consent or confirmation to receive information electronically that the law requires to be delivered in writing (e.g., Truth in Lending disclosures). Before consent can be given, the consumer must receive a disclosure regarding:

- any right or option the customer has to receive disclosures in paper form;

- whether the consent applies only to a particular transaction or to categories of records that may be provided during the course of the parties' relationship;
- the right to withdraw consent to have records provided electronically, including any conditions, consequences, or fees associated with doing so. The institution must describe the procedures for withdrawing consent and for updating information needed to contact the consumer electronically;
- how, after the consent, the consumer may obtain a paper copy of a record upon request; and
- the hardware and software requirements for access to and retention of the electronic information.

ESIGN requires that consumers express their consent electronically, or confirm their consent electronically, in a manner that reasonably demonstrates that the consumer will be able to access required notices or disclosures electronically. If, after consent is provided, a change is made in the hardware or software requirements needed to access or retain the electronic disclosures and the change creates a material risk that the consumer will not be able to access or retain an electronic disclosure that was the subject of the prior consent, the consumer must be provided with an appropriate notice of the change and must re-consent electronically in a manner that reasonably demonstrates the consumer's ability to access the electronic notice or disclosure within the changed hardware or software environment.

B. Under ESIGN and UETA, an issuer (borrower) must expressly agree to treat an electronic record as a transferable record.

An electronic form of promissory note qualifies as a "transferable record" under ESIGN or UETA only with the express agreement of the borrower. This express agreement can be obtained separately from the transferable record or be contained within the transferable record itself. For example, Fannie Mae and Freddie Mac have developed an eNote clause that must be included in any eNote intended to be sold to Fannie Mae or Freddie Mac. The eNote clause articulates the borrower's specific agreement to treat the eNote as a transferable record.

VIII. Electronic Format and Delivery of Consumer Disclosures

The delivery of required consumer disclosures in an electronic mortgage lending environment presents a unique challenge. Not only do some disclosures require an ESIGN consent before they may be provided electronically, lenders will still need to keep in mind that neither ESIGN nor UETA affect any statutory or regulatory requirement regarding the content, proximity or format of any warning, notice, disclosure or other record required to be posted, displayed or publicly affixed. For example, if a required notice must appear immediately above the consumer's signature line in a writing, that requirement must also be met in an electronic environment (e.g., the notice may appear immediately above the portion of the screen where the consumer places her electronic signature, or the notice may be placed in a dialog box that is presented to the consumer just before her signature is added to the record).[9] Additionally, lenders will need to

[9] The electronic medium offers a variety of ways to address proximity and timing requirements in an innovative manner. See Section 3 of SPeRS for more ideas on innovative display of disclosures.

determine that the method they choose for providing electronic disclosures will meet any requirements related to communication, timing, verification or acknowledgment of receipt, storage and retention.

ESIGN contains a few additional limitations on providing disclosures electronically. For example, for disclosures that require an ESIGN consent to be delivered electronically, oral communication of such disclosures to a consumer would not qualify as electronic delivery unless otherwise provided under applicable law. Additionally, ESIGN does not allow the consumer to consent to receive in electronic form any notice of acceleration, repossession, foreclosure, eviction, or right to cure relating to a credit contract secured by the consumer's primary residence.

For compliance guidance on the electronic delivery and retention of consumer disclosures, mortgage lenders should look to federal agency issuances, such as the interim final rules (although they are not mandatory) amending Regulation B and Regulation Z (as discussed below) and advisory letters issued by the Comptroller of the Currency on Electronic Consumer Disclosures and Notices (AL 2004-11) and Electronic Record Keeping (AL 2004-9). Mortgage lenders should also consult SPeRS for additional guidance on effectively obtaining consumer consent and delivering disclosures.

IX. Summary of the Board of Governors of the Federal Reserve System's (FRB) Interim Final Rules

In order to establish uniform standards for the electronic delivery of disclosures required under Regulation Z (Truth in Lending) and Regulation B (Equal Credit Opportunity Act), the FRB released Interim Final Rules in 2001. Since then, the FRB has withdrawn the mandatory compliance date on the Interim Final Rules, but has subsequently advised that compliance with the Interim Final Rules will satisfy the statutory requirements for consumer disclosures under ESIGN. Therefore, the Interim Final Rules provide both a handy reference for issues to address when designing electronic disclosures and insight into the approach regulators are likely to take when evaluating the effectiveness of electronic delivery.

For these reasons, this Section includes a summary of some of the provisions in the Interim Final Rules that may provide guidance for electronic delivery of disclosures in a mortgage lending transaction. However, bear in mind that the Interim Final Rules are not mandatory – an approach to presenting and delivering electronic records in a mortgage transaction that does not comply with the Interim Final Rules may still be sufficient under ESIGN and the UETA.

A. Electronic Delivery Provisions in Regulation Z and Regulation B

1. Requirements for Electronic Communication

Regulation Z and Regulation B define "Electronic Communication" as a message transmitted electronically between a creditor and consumer in a format that allows visual text to be displayed on equipment (e.g. a personal computer monitor). Generally, a creditor may provide, by electronic communication, any disclosure required by Regulation Z or Regulation B to be in writing. Before a creditor can provide such

disclosures electronically, a creditor is usually required to obtain a consumer's affirmative consent to receive such disclosures electronically pursuant to ESIGN.[10]

For purposes of either Regulation Z or Regulation B, a consumer's electronic address is an e-mail address that is not limited to receiving communications transmitted solely by a creditor. For consumer disclosures that require an ESIGN affirmative consent, a creditor shall either (1) send the disclosure to consumer's electronic address; or (2) make the disclosure available at another location (i.e., Internet Web site) and alert the consumer of the availability of the disclosure through a notice sent to the consumer's electronic address. In either situation, the creditor is required to make the disclosure available for at least 90 days from the date disclosure becomes available or from the date of the consumer notice, whichever is later.[11]

If an electronic disclosure is returned to creditor undelivered, the creditor is required to take reasonable steps to redeliver the disclosure using information from its files. If the regulation requires a consumer to sign or initial a particular disclosure, then an electronic signature, as defined by ESIGN, would satisfy this requirement.

For disclosures provided on a creditor's equipment (i.e., a computer terminal in creditor's lobby, ATM at a public kiosk, etc.), the creditor must ensure the equipment satisfies requirements to provide timely disclosures in a clear and conspicuous format that consumer may keep. For example, if disclosures are required at time of the on-line transaction, the disclosures must be sent to consumer's e-mail address or be made available on an Internet Web site, unless the creditor provides a printer that automatically prints the disclosures.

B. Applicability to Delivery of Regulation Z Disclosures

1. ESIGN Consent Required for Transaction-Specific Regulation Z Disclosures

Regulation Z makes a distinction between disclosures specific to a loan transaction and those disclosures that are not (i.e., early shopping disclosures, advertisements, etc.) with respect to the need to obtain a consumer's ESIGN consent. For transaction-specific disclosures required to be in writing (i.e., rescission notices), an affirmative ESIGN consent is required from the consumer before the creditor can deliver such disclosures electronically. On the other hand, disclosures that are not transaction-specific (i.e., early adjustable rate mortgage (ARM) disclosures, early home equity disclosures, credit advertisements, etc.) are permitted to be provided electronically without the consumer's affirmative ESIGN consent.[12]

2. Early Home Equity and Early ARM Disclosures

[10] The Interim Rules articulate a few exceptions to the ESIGN consent rules. See discussion below under "Applicability to Delivery of Regulation Z Disclosures."

[11] The staff of the Federal Reserve Board has referred to this informally as the "kitchen table rule." Disclosures that are provided in writing are not always read immediately – instead, they may be "thrown on the kitchen table" for later review.

[12] Although ESIGN preserves federal rulemaking authority to interpret ESIGN's consumer consent provisions, some commentators to the FRB's Interim Rules have asserted that ESIGN does not actually authorize these exceptions.

With respect to early disclosures required by Regulation Z, a consumer must be able to access the disclosures (including FRB's home equity brochure, if applicable) at the time the blank loan application or reply form is made available by electronic communication, such as on a creditor's Internet Web site. With respect to early home equity disclosures, a creditor can provide these on a Web site using a link to prevent the applicant from bypassing the disclosures before submitting the application. If a link is not used, the application or reply form must clearly and conspicuously refer the consumer to the fact that rate, fee, and other cost information either precedes or follows the application or reply form. As an alternative to a link, a creditor can provide the early home equity disclosures by ensuring that the disclosures automatically appear on the computer screen when the application or reply form appears. A creditor is not required to confirm that the consumer has read the disclosures or the home equity brochure.

3. Notice of Right to Rescind

In any paper-based transaction subject to rescission under Regulation Z, creditors must deliver two copies of the notice of right to rescind to each consumer entitled to rescind. However, if electronic communication (i.e., e-mail) is used for delivery, the Interim Final Rules permit a creditor to comply by sending one notice to each consumer entitled to rescind. However, each consumer must have consented to receive electronic disclosures and each must have designated an electronic address for receiving the disclosure.[13]

C. Applicability to Delivery of Regulation B Disclosures

1. Regulation B Disclosures Given At Time of Application

With respect to Regulation B, if certain disclosures are provided on or with the loan application, the Interim Final Rules suggest that those disclosures are not subject to the affirmative consent requirement under ESIGN. Regulation B disclosures that may be provided on or with the electronic loan application without affirmative consumer consent are the notice of right to receive a copy of the appraisal and the information requested for monitoring purposes.

If the creditor allows an applicant to apply on-line, the applicant must be required to access any disclosure required at application before the consumer is able to submit the application. For example, a creditor can utilize a link to prevent the applicant from bypassing the disclosures before submitting the application or a creditor can have the disclosures appear automatically on the computer screen. In either case, the creditor is not required to confirm that the applicant has read the disclosures.

2. Appraisals and Adverse Action

The commentary to Regulation B provides that disclosures provided by e-mail are timely based on when the disclosures are sent. With respect to disclosures posted at an Internet Web site, such as adverse action notices or copies of appraisals, disclosures are timely when the creditor has (1) made the disclosures available on the Web site and (2) sent a notice alerting the applicant that the disclosures have been posted. For example, under 12 C.F.R. § 202.9, a creditor must provide a notice of action taken within 30 days of

[13] The Rescission Notice is, perhaps, the only disclosure given under Regulation Z that is not constructively delivered to all co-applicants when it is delivered to one of them. Delivering the rescission notices electronically therefore requires special care and attention to detail.

receiving a completed application. For an adverse action notice posted on the Internet, a creditor must post the adverse action notice and notify the applicant of its availability within 30 days of receiving the applicant's completed application.

X. Establishing Control of a Transferable Record

A key aspect of the secondary mortgage market is the mortgage industry's ability to sell mortgage notes. As mentioned above, ESIGN and UETA create a parallel structure for the transfer and negotiability of an electronic promissory note to a third party so that a third party transferee has the rights and defenses analogous to those held by a "holder," or a "holder in due course," under the UCC. The key to the transferability of an electronic record under ESIGN and UETA is "control," which can be thought of as the equivalent of "possession plus delivery and endorsement" in the paper context. ESIGN and UETA provide that a person has "control" of a transferable record if the system employed for evidencing the transfer of interests in the transferable record reliably establishes that person as the person to which the transferable record was issued or transferred.

While this standard stands on its own, UETA and ESIGN offer a "safe harbor" for meeting the control requirement.[14] Control exists if the system for maintaining control meets the list of safe harbor requirements under Section 16(c) of UETA and Section 201(c) of ESIGN, as described below.

A. A single authoritative copy of the record exists that is unique, identifiable, and unalterable without detection.

To qualify as an authoritative copy, an electronic promissory note must be unique, identifiable and unalterable without detection. An electronic promissory note can be unique by having a specific characteristic that distinguishes it from other copies. The characteristic can be provided by technology, by process, or by agreement. For the electronic promissory note to be identifiable, the system being used or the agreement between the parties needs to specify or describe the unique feature that identifies the authoritative copy and how that unique feature can be accessed or confirmed. The electronic record must be protected or monitored so that alterations can be identified as authorized or unauthorized.[15]

B. The authoritative copy identifies the person asserting control as either the person to whom the transferable record was issued or the person to whom the transferable record was most recently transferred.

The authoritative copy must be tied to a system or process for identifying the current party in control of the record. This can be accomplished either (1) through information logically associated with the authoritative copy, or (2) through the use of a trusted third party registry, which is referenced in the authoritative copy of the record.[16] For example,

[14]Neither UETA nor ESIGN expressly requires that the safe harbor requirements be met in order to establish control. A system that meets the safe harbor will establish control – however, it is both conceivable and probable that many systems not meeting the safe harbor's requirements would also establish control.

[15] UETA and ESIGN leave to other law the question of who can authorize alterations to the transferable record. In general, except as otherwise agreed, only the issuer of a negotiable promissory note can authorize alterations (other than the addition of endorsements by the holders).

[16] The use of a registry system that is cross-referenced in the authoritative copy, rather than an addition to the record itself, is discussed in the commentary to the UETA.

the MERS® eRegistry was designed as an industry utility serving as the central location to identify the current person in control and the location of the authoritative copy of the electronic promissory note. Language, such as Fannie Mae and Freddie Mac's eNote clause, is included in the electronic promissory note referencing the MERS® eRegistry or another trusted third party registry, as the system for identifying the person in control of the electronic promissory note.

C. The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian.
The person asserting control of the authoritative copy or her designated custodian would be equivalent to the person who is authorized to possess the physical promissory note in a paper environment. As a result, the person asserting control or his or her custodian must have access to the authoritative copy and be able to maintain the authoritative copy without the ability for others to duplicate or acquire the authoritative copy without their permission.

D. Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control.
ESIGN and UETA permit an authoritative copy to be revised in order to add or change its identified assignee, but only with the consent of the person asserting control.

E. Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy.
All copies of the authoritative copy of the electronic promissory note need to be readily identifiable as such. This can be accomplished, for example, by inserting language into the electronic promissory note that gives third parties notice that they may not be viewing the authoritative copy of the note and that they would need to check a designated third party registry (i.e., the MERS® eRegistry) in order to determine the actual location of the authoritative copy. Fannie Mae and Freddie Mac drafted the eNote clause for their Uniform Instruments to meet this requirement.

F. Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.
Revisions to an authoritative copy, such as modifications to an electronic promissory note, must be identifiable as authorized or unauthorized. This can be accomplished using a trusted third party registry, such as the MERS® eRegistry. Whenever a modification is created and agreed upon by the person in control and the obligor(s) to the electronic promissory note, the modification can be registered on the third party registry in such a way that it is associated with the original electronic promissory note. Any persons that

> The control requirements may be satisfied through the use of a trusted third party registry system. Such systems are currently in place with regard to the transfer of securities entitlements under Article 8 of the Uniform Commercial Code, and in the transfer of cotton warehouse receipts under the program sponsored by the United States Department of Agriculture. This Act would recognize the use of such a system so long as the standards of subsection (c) were satisfied. In addition, a technological system which met such exacting standards would also be permitted under Section 16.

UETA, Reporter's Comments to Section 16, Comment 3.

check the registry will be put on notice that a modification to the electronic promissory note exists.

XI. eNotarization

Notarization plays an important role in a real estate transaction because, for example, documents to be recorded in a land record system are generally required to be notarized. The essential components of notarization are (1) personal appearance of the signer before the notary, (2) proof of identity of the signer, (3) acknowledgment by the signer that he or she intends to create a binding agreement, (4) observation by the notary that the signer does not appear to be acting under threat or duress, and (5) observation by the notary that the signer appears to be aware of the document signing. These steps assist in detecting attempted fraud or deterring fraud in a loan closing and create evidence of the validity of the transaction. To achieve these goals, an electronic loan closing system should implement electronic notarization in a way that meets applicable legal requirements and provides evidence of notarization of a document sought to be enforced in court.

A. Notarization under UETA and ESIGN

Notaries in the United States entered a new era in 1999 when UETA was published. UETA specifically allows for the use of electronic signatures by notaries:

> Section 11. Notarization and Acknowledgment. If a law requires a signature or record to be notarized, acknowledged, verified, or made under oath, the requirement is satisfied if the electronic signature of the person authorized to perform those acts, together with all other information required to be included by other applicable law, is attached to or logically associated with the signature or record.

Additionally, ESIGN closely tracks UETA, including the provision on use of electronic signatures by notaries:

> Subsection 101(g). Notarization and Acknowledgment. If a statute, regulation, or other rule of law requires a signature or record relating to a transaction in or affecting interstate or foreign commerce to be notarized, acknowledged, verified, or made under oath, that requirement is satisfied if the electronic signature of the person authorized to perform those acts, together with all other information required to be included by other applicable statute, regulation, or rule of law, is attached to or logically associated with the signature or record.

The legislative history of ESIGN indicates that 101(g) is intended to remove any requirement of a stamp, seal, or similar embossing device, as applicable, for electronic notarizations. This notation recognizes that the notary's seal may be represented simply as "information" (textual or otherwise) on an electronic document, as long as that data conforms to existing state laws concerning the information that must be conveyed by the notary's seal. However, the fact that ESIGN itself does not directly address the removal of the seal requirement specifically raises interpretative issues that many real estate and legal professionals would like to see clarified by statute.

B. State Laws and Regulations Enabling eNotarization

States have adopted or are currently working on adopting legislation to support electronic notarization, including clarification of the status of seals. NCCUSL's draft of the Uniform Real Property Electronic Recording Act (URPERA) [Sec. 3(c)], which some states have already adopted, effectively duplicates the UETA and ESIGN language regarding the use of electronic signatures by notaries and adds a provision that the notary's seal need not be displayed as a physical or visual image on an electronic document being recorded.

Notarial law varies widely from state to state, and must be taken into account in addition to ESIGN, UETA, and URPERA when contemplating the use of electronic notarization. The Model Notary Act was updated in 2002 to provide a comprehensive system of authorization and regulation of electronic notarization. The electronic notarization provisions of this Act have been adopted in their entirety in North Carolina and are under consideration in other states. In addition, the Act's requirement that notaries specially register with the state commissioning official before performing electronic notarizations has been adopted in Alaska, Colorado, Kansas and Pennsylvania. Requirements for affixing and securing the notary's electronic signature and seal on electronic documents also have been adopted in Arizona and California and are under consideration in other states. For example, some states may require or recommend that electronic notarization be implemented using document integrity measures that help establish that the notary's electronic signature is associated with the document that the notary signed and that the document is genuine and unaltered at the time of signing.

These legislative efforts will bring clarity to the legal effect of electronically notarized documents and will establish the rules, procedures, and guidelines that govern notary practice in the electronic age. Parties interested in eNotarizaton should determine whether their state has, or will implement laws or regulations governing eNotarization. Additional guidance can also be found through state or national notary professional organizations.

XII. eRecording

Implementation of electronic recording (eRecording) necessarily implies that the real estate document being submitted for filing in the public land records is a valid electronic document and that the receiving body is authorized and willing to accept the electronic record for recording. Fortunately, the broad nature of ESIGN and UETA permits real estate documents to be in electronic format, to contain electronic signatures, and to be accepted for filing in the event county recorders choose to do so. However, there has been a lot of discussion as to whether ESIGN or UETA, without additional state law, provide county recorders with the authority to engage in electronic recordation. URPERA also addresses the recordation of electronic records in the public land records.

ESIGN and UETA's general rules of validity similarly provide that, with respect to a "transaction," a record or signature may not be denied legal effect or enforceability solely because it is in electronic form. Both ESIGN and UETA define a "transaction" as an action or set of actions relating to the conduct of business, consumer, commercial affairs between two or more persons, and in the case of UETA, the definition of "transaction" additionally covers governmental activities. In addition, ESIGN's definition of

"transaction" specifically includes the sale, lease, exchange, or other disposition of any interest in real property. Real estate documents, such as deeds of trusts and mortgages, often have to be notarized or acknowledged under applicable state law. ESIGN and UETA provide that this requirement can be met if the electronic signature of the notary or other authorized person is attached to or logically associated with the electronic real estate document. Therefore, ESIGN or UETA do not specifically preclude real estate documents from being in an electronic format or having electronic signatures.

A. ESIGN and UETA, as applicable, may be written broadly enough to allow a county recorder the choice of accepting electronic real estate documents for recording. ESIGN and UETA do not mandate that county recorders accept electronic real estate documents for recording. However, since ESIGN and UETA provide that electronic records and electronic signatures are legally equivalent to paper records and ink signatures, a county recorder can choose to accept electronic real estate documents for recording, subject to any record standards or format requirements issued by a federal or state regulatory agency or self-regulatory organization.

State attorneys general and the Property Records Industry Association (PRIA) have differing opinions on whether ESIGN and UETA give county recorders sufficient authority to accept electronic real estate documents, including scanned documents, for recording. Several state attorneys general ("AGs"), including those in California and New York, have issued opinions in recent years maintaining that ESIGN and UETA, without additional state law, do not require a county recorder to accept electronic documents, including documents with electronic signatures, for recording. The AGs' opinions stipulate that electronic real estate documents are legal and enforceable between the parties to a particular transaction. However, the opinions point out the difference between enforcing the underlying real estate document between parties and the distinct activity, under state statutes that require the filing of paper documents with "live" signatures, of accepting an electronic document for recording in the public land records to give third parties notice of rights in a parcel of real property. There is also controversy regarding whether scanned documents (i.e., paper documents converted to electronic form) meet state requirements that an "original" document or document containing an "original signature" be presented for recording. California, New York and Texas attorneys general have asserted that scanned documents and/or scanned signatures are only copies of original documents or signatures.

PRIA and the Electronic Financial Services Council (EFSC) have taken the position that ESIGN and UETA do provide a clear basis for recordation of electronic real estate documents. With regard to scanned images, PRIA and EFSC maintain that the definition of "electronic" includes a scanned image. This opinion is supported by the UETA commentary which makes it clear that "electronic data interchange, electronic mail, voice mail, facsimile, telex, telecopying, scanning and similar technologies" would qualify as electronic.

As a result of these differing views, mortgage lenders should consult with the particular counties and the state attorney generals' offices in the states in which they wish to submit

electronic or scanned documents for recording to determine whether such states or counties recognize the validity of electronic real estate document filings.

B. URPERA and other state laws clarify the authority of county recorders to accept electronic real estate documents for recording.

To clear up confusion as to whether electronic real estate documents (including scanned documents) may be accepted for recording and to establish electronic recording standards for county recorders to follow, NCCUSL published URPERA in August 2004. If adopted by a state, URPERA will give county clerks and recorders the legal authority to prepare for and develop systems to accept electronic recording of real property instruments. Similar to ESIGN and UETA, URPERA reiterates that electronic documents and electronic signatures will satisfy any state recording laws that require a document to be an "original" or "in writing," and to contain original or written signatures, notarizations and acknowledgments. URPERA also provides that any state electronic recording commission or agency responsible for setting electronic recording standards must consider the standards and practices of other jurisdictions and the standards promulgated by national standard-setting bodies (e.g., PRIA), in addition to considering the needs of its counties and views of interested persons. Several states have already adopted URPERA while other states have bills on URPERA pending.

Additionally, states such as California and Colorado, have adopted separate statutes that provide for the acceptance of electronic real estate documents, including, in some cases, digitized images of electronic real estate documents, for recording.

XIII. Evidentiary Importance of an Audit Trail

One of the advantages of migrating from a traditional loan closing process to an electronic loan one is the opportunity for an electronic loan closing system to capture and retain a reliable and trustworthy audit trail. Such an audit trail can be used to capture data or information that represents each of the critical events in an electronic loan closing. For example, the audit trail data could include information such as the date and time a person electronically signed a particular document and the contents of that document at the moment the person's signature was captured.

In examining the usefulness of an audit trail feature in an electronic closing system, an originator, lender, or title insurer should keep in mind federal and state rules of evidence governing the admissibility of computer records, such as an audit trail. For example, under Rule 901 of the Federal Rules of Evidence, computer records generally are not admissible unless the person presenting the computer records provides "evidence describing the process or system used to produce a result and showing that the process or system produces an accurate result." This evidence may be provided by a person's testimony or documentation that describes in detail how the audit trail function works and what features preserve the accuracy and integrity of the audit trail data.

XIV. Data Security

Since an electronic mortgage transaction invariably handles sensitive customer information, compliance with applicable privacy and data security laws and regulations are critical, especially from a business and reputational risk management perspective. On

the federal level, the Gramm-Leach-Bliley Act ("GLB") sets forth requirements for protecting the privacy of a person's financial information held by financial institutions (e.g., banks, thrifts, credit unions, insurance companies, finance companies, other non-bank entities offering financial products, etc.). The GLB Act provides federal regulatory agencies[17] with the authority to issue and enforce regulations regarding the collection and disclosure of customer information, and the establishment of safeguards to protect customer information from access by unauthorized persons. For the purposes of this Guide, we will focus on the GLB Act's requirement that financial institutions ensure the privacy and security of customer information.

Pursuant to the GLB Act, the federal regulatory agencies have issued guidelines establishing standards for safeguarding customer information from unauthorized access (known as the "Safeguards Rule" for FTC-regulated institutions and the "Security Guidelines" for depository institutions). Generally, the Security Guidelines set forth standards for developing, implementing, and maintaining reasonable administrative, technical, and physical safeguards to: (1) ensure the security and confidentiality of customer information; (2) protect against any anticipated threats or hazards to the security or integrity of such information; and (3) protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Security Guidelines require financial institutions to have reasonable policies and procedures in place to safeguard the security and confidentiality of customer information and to ensure proper disposal of customer information.[18] The Guidelines require financial institutions to implement a written information security program that is appropriate to the company's size and complexity, the nature and scope of its activities, and the sensitivity of the customer information it handles. Among other requirements, a financial institution's information security program needs to require service providers, by written contract, to protect and properly dispose of a customer's personal information. For more guidance on how to comply with the Security Guidelines, mortgage lenders should review the Interagency Guidelines Establishing Information Security Standards: Small Entity Compliance Guide.[19]

In addition to the Security Guidelines, several states have passed or are considering the passage of laws and regulations requiring companies to safeguard customer information that they maintain and to notify consumers of security breaches involving consumers' personal information. For example, the California security breach notification law (SB 1386), which applies to all organizations who maintain "personal information" on California residents, to notify such residents in the event their unencrypted personal

[17] The federal regulatory agencies with supervision over financial institutions usually involved in mortgage lending are the Comptroller of the Currency, the Office of Thrift Supervision, the Board of Governors of the Federal Reserve, the National Credit Union Association, and the Federal Trade Commission.

[18] Section 216 of the Fair and Accurate Credit Transactions Act of 2003 requires entities to properly dispose of consumer information derived from credit reports. The federal bank and thrift regulatory agencies incorporated guidance on how to comply with this requirement within its Security Guidelines. For institutions regulated by the FTC, the disposal guidance is contained within the FTC's Disposal Rule which is available at http://www.ftc.gov/os/2004/11/041118disposalfrn.pdf.

[19] The Small Entity Compliance Guide was published on December 15, 2005 and is available at http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051214/attachment.pdf.

information is compromised. Under California's law, "personal information" includes an individual's first name or first initial and last name in combination with one or more of the following: (1) a social security number, (2) drivers license or California identification card number, (3) account number, and/or credit or debit card information including numbers and passwords, personal identification numbers (PINs) and access codes. Some states, notably New York and New Jersey, require notification to state law enforcement and/or regulatory agencies, in addition to notice to affected consumers. As a result, lenders should ensure that closing systems that handle this type of information have appropriate access controls, encryption, and policies regarding secure communication to mitigate the risk of security breach.

As a result of these data security compliance concerns, mortgage lenders should ensure that any electronic loan closing process and system is designed to safeguard and handle customer information appropriately. Since identity theft and security breach risks continue to be a concern among legislators, regulators, and consumers, mortgage lenders should expect more federal and state laws, regulations and guidance in the data privacy and security area.

XV. Title Insurance Coverage for eMortgages

Title insurance typically provides insurance coverage for the validity and enforceability of an insured mortgage as against insured land. In the past, both the note evidencing debt and the mortgage which secures performance of the note by creating a security interest in land were created by hand-made signatures on paper documents. Currently, there is a small, but growing, number of lenders originating mortgage loans in which the note is signed and created electronically while the accompanying mortgage or deed of trust is ink-signed and created on paper. In the future, it is expected that both the note and mortgage may be signed and created electronically. Whether the execution of the note or mortgage occurs with an ink or electronic signature, it is expected that the traditional coverage of the loan policy of title insurance will remain unchanged for real estate transactions in which title insurance is obtained.

The American Land Title Association recognizes the legal and technological advances that support the creation of enforceable electronic mortgage transactions. With this recognition, the Association is anticipating the approval of a new loan policy form by July 1, 2006 that explicitly includes insurance against the invalidity or unenforceability of the lien of the insured mortgage because of "failure to perform those acts necessary to create a document by electronic means authorized by law." It is widely agreed that this coverage will insure against invalidity of the insured mortgage because of failure of the promissory note or mortgage to be created in accordance with applicable electronic transactions laws. Notwithstanding publication of the new loan policy form, the 1992 ALTA Loan Policy provides the same insurance by insuring provision 5, which insures against "The invalidity or unenforceability of the lien of the insured mortgage upon the title."

XVI. Compliance with ESIGN and UETA Document Retention Requirements

A. ESIGN Requirements for Retention

Since an electronic closing system will store electronic documents before, during and after the loan closing event, the system would need to be designed in compliance with applicable federal and state document retention requirements. For example, ESIGN generally provides that electronic signatures and records may not be denied legal effect solely because the records are electronic. However, if electronic signatures and records are not stored in an accessible and accurate manner, these records and signatures may be denied legal effect.

This integration of accessibility, accuracy, and validity raises the issue of technology obsolescence. Regular testing, monitoring, and conversion procedures are essential for ESIGN compliance. If consumers are accessing an electronic vault or other electronic document storage repository in conjunction with the ESIGN consent process, any changes to the software or hardware requirements for electronic vault accessibility must be disclosed to the consumer in a particular manner. The hardware or software disclosures must be accompanied by a notice to the consumer about the consumer's ability to withdraw consent to the use of electronic records.

ESIGN permits a federal or state regulatory agency to specify performance standards to assure accuracy, record integrity, and accessibility of electronic records. Therefore, special care should be taken to ensure that any storage system complies with applicable regulatory requirements as. ESIGN also permits a federal or state regulatory agency to require the retention of a record in a tangible printed or paper form. Therefore, consultation with qualified counsel and appropriate regulatory agencies is advisable before developing an electronic vault or other electronic document storage repository.

The legislative history of ESIGN references the Securities and Exchange Commission's (SEC) rule on electronic storage for information purposes. Specifically, the SEC rule requires that the electronic storage media (i) preserve the records exclusively in a non-rewriteable, non-erasable format; (ii) verify automatically the quality and accuracy of the storage media recording process; (iii) serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media; and (iv) have the capacity to readily download indexes and records preserved on the electronic storage media to any medium acceptable as required. To ensure compliance with the SEC rule, entities must have an audit system in place that provides for accountability regarding the entry of records that must be maintained and preserved by the storage system. All of the procedures in the rule are instructive for structuring an electronic record storage system for the mortgage industry.

B. UETA Requirements for Retention

The concept of retention is incorporated into several provisions in the UETA. UETA's definition of "record" incorporates a retention requirement, stating that a record is information that is stored in an electronic or other medium and is retrievable in perceivable form. In the comments, the UETA drafters note that "[i]nformation that has not been retained other than through human memory does not qualify as a record." Therefore, retention is a key element for compliance with the UETA.

UETA provides that retention of electronic records may satisfy existing record retention requirements if such records are accurate and remain accessible for later reference. The requirement of accuracy, in the electronic records context, addresses the issue that some modes of electronic storage may be more prone to data corruption than others. The continuing accessibility requirement addresses the issue of potential technological obsolescence of storage technology. As storage technology becomes obsolete, conversion of the data into new formats is required to maintain compliance with this accessibility requirement.

The scope of information in an electronic record required to be stored under UETA's retention requirements is determined by the purpose for which the information is needed. However, wise record retention would retain as much information as possible in an electronic record since it may not be known at the time the record is placed in storage what information will later be relevant.

C. Compliance with Underlying Statutory and Regulatory Obligations

While ESIGN and UETA provide for the use of electronic records, ESIGN and UETA do not affect the requirement to comply with existing statutory or regulatory document retention requirements. Such requirements may originate under federal or state laws and regulations. For example, UETA provides that a governmental agency of the State may specify additional requirements for the retention of a record subject to the agency's jurisdiction. Electronic records must also be stored in a manner that ensures that these records will later be admissible in federal or state court. Rules on the admissibility of these records into evidence may vary from state to state. Electronic storage systems must also be developed in a manner that complies with security and privacy laws regarding customer information applicable to a particular institution.

XVII. Conclusion

A legal infrastructure exists for developing processes for an electronic loan closing, and in turn, creating valid and enforceable electronic loan obligations. An electronic loan closing must take into account traditional loan closing laws, as well as other laws applicable to any type of electronic commerce transaction. While this summary does not cover every legal topic raised by an electronic loan closing, it provides a preliminary overview for institutions selecting or developing an electronic loan closing process or system.

3.2 eDoc Guidelines

Introduction
An electronic document (eDoc) is intended to provide an equivalent to a paper document without a need for printing. The desire for a paperless environment has been a key driver in the evolution of the eDoc formats from imaging to electronic records. Legislatively, ESIGN and UETA similarly define an electronic record as a record "created, generated, sent, communicated, received, or stored by electronic means." Although electronic records are the legal equivalent of paper records, proving the enforceability of such records may rely on evidence within a particular document and the circumstances surrounding the creation, execution, maintenance, and storage of such document. This Section is a general discussion on how an electronic document format used within an electronic closing system can be designed to create evidentiary support for proving enforceability.

Key Points
The MISMO eMortgage Guidelines and Specifications include electronic document format guidelines that support the industry's evolutionary progress from imaging to electronic records and assist the industry in achieving incremental benefits along the way. The guidelines describe five key document characteristics which are **S**ecurable, **M**anageable, **A**rchivable, **R**etrievable, and **T**ransferable, thus creating a SMART™ electronic document. The guidelines also provide guidance on the following document format requirements:

- Information describing the document.
- Visual representation of the document.
- Data embedded in the document.
- Transparent linking of the data and visual representation.
- Electronic signatures in the document.
- Tamper-evident security in the document.
- Audit trail of changes in the document.

General requirements
An electronically signed document should contain all the information necessary to reproduce the entire electronic document and all associated signatures in a form that permits the person viewing or printing the entire electronic document to verify:

(a) The contents of the electronic document;
(b) The method used to sign the electronic record, if applicable; and
(c) The person or persons signing the electronic document.

Since some electronic mortgage documents will need to be retained for the life of the loan plus 7 years, rendering of an electronically signed document should be reliant solely upon a single file containing the necessary components – data, view, mapping, signatures, and any additional files – in a single electronic document file, without requiring external

files or attachments. Additionally, in order to ensure accuracy of the electronic document during the documents' retention period, subsequent renderings of the document should be consistent, without alterations or changes, in order to preserve the original unique customer experience.

During the closing session, the borrower(s) must have the ability to view the entire document that they will be required to view, acknowledge, and/or sign. If this ability is restricted or limited by the electronic closing system used, a borrower might assert that the electronic closing transaction was conducted unfairly or deceptively, and might bring an action under applicable state law governing unfair and deceptive acts and practices. Certain laws may require that the information be presented in a particular format (i.e., 12-point font, clear and conspicuous requirements, etc.). The closing system must display such documents in any legally-required format.

An electronically signed document should support electronic signatures from multiple parties and all required signatures must be affixed to the document. The supported type(s) of electronic signature(s) must comply with all applicable electronic signature laws and regulations (e.g., E-SIGN and UETA).

To assist in proving attribution of an electronic signature, each signature block on the document should contain the signature symbol of the signer (e.g., handwritten signature, certificate information, etc.) and the date and time of when the signature was applied by the signer. See Section 3.1 for more discussion on Electronic Signatures and Attribution.

To preserve the evidence that a document was signed by a borrower, it may be helpful for the electronic document to contain an audit trail that can capture information on each electronic signing event along with other revisions to the document. Systems storing and managing electronic documents should protect any existing recorded audit trail events from being altered or deleted.

To preserve the integrity of the electronically signed document, an electronic document should be tamper-evident sealed using W3C compliant digital signature algorithms and utilizing X.509 certificates issued by a SISAC-accredited issuing authority. The tamper-evident seal digital signature value must be included in the document and accessible to validate that the electronic document has not been altered after it was electronically signed.

For additional format specific requirements, please refer to the MISMO® eMortgage guidelines and specifications available at www.mismo.org.

References:

1. U.S. Courts - Electronic Case Files
   http://www.uscourts.gov/cmecf/cmecf_about.html
   http://pacer.psc.uscourts.gov/cmecf/developer/bkforms/DEfaq.pdf
2. The Government Paperwork Elimination Act
   http://www.archives.gov/records-mgmt/policy/electronic-signature-technology.html
3. The National Archives - Permanent Electronic Records
   http://www.archives.gov/records-mgmt/initiatives/pdf-records.html

4. The United Nations – eDoc Standards
   http://www.unece.org/etrades/unedocs/referenceimpl_ac.htm

3.3 eSignature Guidelines

Introduction
An electronic loan closing system and/or process needs to be designed to create valid and enforceable electronic signatures. Regardless of the chosen technology or implementation method, originators, lenders, and title insurers should ensure that a closing system or process produces electronically-signed documents and disclosures in such a way that (1) the signer's intent to sign such documents; (2) the authenticity of the signature; and (3) the integrity of the document are demonstrable in a court of law.

For a general legal discussion on electronic signatures and attribution of such signatures, see Section 3.1. In general, an electronic signature is intended to provide an equivalent to the "wet signature" used to sign paper documents. An electronic signature is broadly 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.

Key Points
ESIGN and UETA do not specify what an electronic signature should look like or what technology to use. However, the ESIGN and UETA electronic signature definitions are focused on three signature types: process, symbol, and sound. From a technical point of view, all electronic signatures require some type of "process" in order to result in an electronic symbol or sound that is attached to or logically associated with the electronic record. This remains true regardless of whether the signature is digital, electronically handwritten, "click-through," or results from some other procedure.

In addition, while the authentication of the identity of a signer need not be part of the signature itself, it is important to remember that electronic signatures will usually need to be associated, in some way, with a process that establishes the identity of the signer. An electronic signature method could be designed to include a stronger or weaker authentication process depending upon practical considerations and the nature of the underlying transaction. Digital certificates or user IDs for "click-through", as an example, can be issued with varying levels of data and verification of credentials based on the type and value of the transaction, regulatory requirements, and the company's risk tolerance levels.

This Section of the Guide will provide some common examples of electronic signatures used by the mortgage industry today. This is not intended to suggest that other types of electronic signatures are less effectual or should be avoided. In addition, this Section will provide some issues to be considered in designing and selecting an electronic signature process within an electronic closing system.

Electronic Signature Types
Click-through Signature and Password
Description: Click on an "I agree" button or other similar process resulting in an electronic signature or symbol.

Depending on the particular document, a click-through signature, by itself, may not be desirable without additional processes. For example, some websites provide a license agreement that requires a user to click-sign an "I agree" button to the terms and conditions before the software can be accessed and/or downloaded. Typically, the website is programmed to store two records: (1) a generic copy of the license agreement and (2) a separate record of the user's click signature rather than an independent record of a signed license agreement. Since there may be a risk of the two records being disassociated, this type of process may not be sufficient for certain electronic mortgage documents (i.e., an eNote) that are necessary to prove the enforceability of the mortgage transaction and must be retained for the life of the loan plus seven years. For such critical documents, it may be desirable to have all signature information included within the electronic document, rather than having to reference the signature information from an external source. In addition, copies of certain documents required to be provided to the borrower should reflect the documents as they appeared when actually signed by the borrower, preferably with a visual symbol of his or her signature on the electronic document along with the date and time of signature.

As a result, an originator or lender may want to combine a click-through signature method with processes that (1) result in a signature symbol appearing on the electronic document; (2) attribute the signer with his or her signature on the electronic document; and (3) verify a signer's intent to sign. This may be done through a variety of means. One way to incorporate such authentication and attribution processes into a click-through signature method would be to require the signatory to use a single-use password to access the electronic closing session. This password would be issued to an individual whose identity had been confirmed by other means (i.e., verification of identity by a notary, etc.) via mail or other secure method prior to the signing transaction.. See Section 3.1 for more information regarding the legal issues surrounding verification of identity. If a password is used, it should be accompanied by instructions describing how this password will be used along with the click-through signature process, to effect a person's electronic signature on the electronic records.

The closing system should be designed to ensure that the password is not accessible to any other party in the closing process in order to prevent misuse. The usage of a password may provide additional evidence to assist in demonstrating the intent of the signer to be bound to the terms and conditions of the electronic document and may provide additional verification that a closing document was signed by a particular individual.

Handwritten Electronic Signature (also known as Digitized Signature):
Description: Recording of a handwritten signature captured from either a signature capture device or a tablet PC.

A digitized signature is represented as an image of a handwritten signature for display within the electronic document with which it is associated. This signature method has the advantage of being intuitive to the average user and is culturally acceptable in an environment that has traditionally used handwritten signatures to memorialize one's assent to be bound to a written agreement. It also has the benefit of being comparable to

the handwritten wet ink signature of the signer, thus providing one method, but not necessarily the only method, of associating the signer with his or her signature on the electronic document.

Prior to the execution of a digitized, or handwritten, electronic signature, the signature procedure should be explained to the signer. Handwritten electronic signatures are typically captured using a tablet computer (PC) or a special-purpose computer peripheral.

Digital Signature

Description: The application of cryptography, i.e., using public and private keys, to a document to authenticate and validate the signer's identity, ensure document integrity, and prevent signer repudiation of his or her signature on the document.

Digital signature technology is used in many IT security, e-business and e-commerce transactions conducted today. It is based on public/private key cryptography, and is used in secure messaging, public key infrastructure (PKI), virtual private networks (VPN), web standards for secure transactions, and electronic signatures. These algorithms can be found in the Public Key Cryptography Standards (PKCS) maintained by RSA Security.

When digital signature technology is used to authenticate a particular individual, the individual's public key is digitally signed with the issuer's private key to verify the signer's identity. This process produces a managed digital certificate – the most common format used today is called X.509 V3. See the ITU standard X.509 for technical details of digital certificates.

The entire process of issuing, verifying and managing digital certificates and keys as a secure process is known as PKI. The standards for managing a digital certificate infrastructure are beyond the scope of this document. Please refer to the IETF workgroup X.509 (pkix) for further details on implementing PKI infrastructure.

While the public and private key pairs used in a digital signature are unique and can authenticate data for a very simple process, signing ceremonies are not typically simple. Therefore, developers of electronic closing platforms, if looking to leverage PKI and digital signatures and certificates, should review the guidelines from the American Bar Association to ensure proper implementation of this technology available at http://www.abanet.org/scitech/ec/isc/pagv30d5_d8.pdf.

Some Best Practice Guidelines

Regardless of what type of signature method is used, a company choosing an electronic closing system design may want to ensure that the system allows for an electronic signature to be associated with the specific electronic document or section of the electronic document to which the signature is applied. For example, the system could enable a message box to appear prior to signing that states, "By [description of electronic signature process (i.e.,clicking on the "I agree" button)], you are creating an electronic signature that reflects your understanding of the terms and conditions of the XYZ

document and your agreement to be legally bound by such terms and conditions." This message should be tailored based on the type of signature process and the signing purpose; consult your legal counsel or compliance officer for further guidance on specific verbiage. See SPeRS for additional guidance in designing an electronic signature process.

An electronic closing platform should also apply a final, official signature (e.g., tamper-evident digital signature) to the document to protect the document from subsequent alterations after all required participant signatures have been captured. In addition, prior to embedding the official signature in the electronic document, it may be desirable that the closing system request a final confirmation of the signer's intent. This can be done by programmatic means or by requiring a manual review of appropriate content in the document, preferably located immediately above the signing section. See Section 3.5 for more guidance on the use of tamper-evident digital signatures.

Other Considerations

Originators and lenders should evaluate what types of signature processes are appropriate for the particular transactions to be conducted electronically. Regardless of what signature method is used, the key to the enforceability of an electronically signed document is having the related evidentiary support necessary to prove that a signature belongs to a particular person (attribution and signer authentication), that the person intended and was authorized to sign the document (intent and authority), and that the document signed is the same document that was presented to the signer (document authentication). If appropriate, an electronic signature process may be designed to provide such evidentiary support. This Section outlines some issues that an originator, lender or title insurer may want consider in conducting due diligence on the electronic signature functionality in an electronic closing system or process. SPeRS provides more in-depth guidance on all of these topics.

Authentication & Authority

One of the key elements to enforceability of any contract is providing verification of the identity of the signer(s) and a determination that the signer had the legal authority to sign. Identity and authority may be established as part of the signature process, or established separately either before or after the signature is created. As a simple example, consider a notarized signature by an individual – the notary observes the signature being created and associated to a record by the individual (or observes the individual acknowledging the signature after creation), confirms in some accepted manner the individual's identity, and affirms the authenticity of the individual's signature.

Providing Information on the Signing Process

Since electronic signatures are a relatively new phenomenon for the typical consumer, it may be prudent to provide an explanation of how the electronic signing process will occur. The explanation should include, at a minimum:

- A description and explanation of the procedure used to create the electronic signature; and
- A description of the sequence of events that will result in the signature becoming final and effective.

Establishing the Intent to Sign

The process used to create an electronic signature may be designed so that:

- It is clear that the signer intended to create a signature; and
- When not reasonably apparent under the circumstances, the signer is advised that the signature fulfills one or more purposes:
  - Affirms the accuracy of information in the record;
  - Affirms assent or agreement with the information in the record;
  - Affirms the signer's opportunity to become familiar with information in the record;
  - Affirms the source of the information in the record; or
  - Other specified purposes.

Associating an Electronic Signature with a Record

A process for signing records may be designed so that:

- The record is presented for signature before the signature is applied;
- The signature is attached to, embedded or logically associated with, the record presented; and
- The process used to attach, embed or associate the signature ensures that the signature is verifiable.

Attributing a Signature

A process for signing the records may be designed so that either:

- The signature itself provides evidence of the signer's identity:
  - i.e. Handwritten electronic signature, digitized signature or digital certificate text; or
- The process surrounding the creation or affirmation of the signature:
  - Provides evidence of the signer's identity; and
  - Is in some manner preserved or capable of recall or re-creation during the applicable life of the transaction.

Conclusion

Although UETA and ESIGN provide basic requirements for a valid electronic signature, there may be other business and practical considerations that will help lenders determine which electronic signature process is appropriate for the particular type of electronic closing transaction.

3.4 eNotary Guidelines

Introduction
An electronic loan closing system should be designed to accommodate the participation of a person authorized to perform notarial acts (e.g., state-commissioned notary) during the closing transaction. A closing transaction typically requires one or more documents to be notarized, particularly documents that need to be recorded by a county recorder. The participation of a notary in an electronic closing transaction would assist in detecting attempted fraud or deterring fraud in a loan closing and would establish presumptive evidence of the document signer's intent to authenticate the document by enabling the notary to: (1) attest to the signer's voluntary execution and understanding of the nature of the document; and (2) verify the identity of the document signer.

For additional information, please reference the work of the American Bar Association (ABA) eTrust subcommittee on eNotarization.

Key Documents
In a typical real estate loan closing transaction, the following are commonly notarized documents: deeds, security instruments, affidavits, powers of attorney, assignments, subordination agreements, reconveyances, lien releases, mortgage satisfactions, and identity verifications.

Guiding Principles
More information about the general legal principles concerning electronic signatures and notarizations is discussed in Section 3.1 of this Guide. In addition, the reader should consult applicable state laws, regulations, and official directives for specific information about notary practices and procedures.

In general, the traditional procedures for paper notarizations are the standards for electronic notarizations. Existing legal requirements for paper-based notarial acts, in other words, must be satisfied in the electronic realm as well. These procedures generally include, but are not limited to:

- *Signer appearance:* In all 50 states, the document signer must appear in person before a notary.
- *Signer screening:* A notary verifies a signer's identity, willingness to sign, and basic understanding of the nature of the document being signed (awareness/capacity).
- *Signer declaration:* A notary takes the document signer's acknowledgment (or witnesses the document signer's signature) or sworn oath (or affirmation).
- *Notary certification:* A notary completes and signs the appropriate certificate according to state law.

Electronic Notary Signature Recommendations
In selecting or building an electronic loan closing system, interested parties (e.g., originators, lenders, title insurers, etc.) need to understand how state laws and rules may affect a notary's use of electronic signatures during a loan closing transaction. Generally,

unless a law or rule directs otherwise, notaries may use any technology to affix or logically associate an electronic signature to notarize a particular document. However, state laws or rules may require that a notary register his or her electronic signature with a notary commissioning official and may prescribe procedures governing its use and security for the purpose of notarial acts. For a general discussion regarding the implementation of electronic signatures, see Section 3.3 of this Guide.

To achieve the basic evidentiary purposes of signatures, a notary's electronic signature should have the following attributes: (1) the name of the notary who signed the document; (2) the notary's commission expiration date; and (3) if applicable, the notary's commission number.

Electronic Notary Seal Information Recommendations

Applicable law or regulation may require or recommend that a notary seal or seal information is attached to or logically associated with an electronic document. Such seal or seal information may be represented as an image or textual information. Closing systems should take into account that this information should be reasonably protected from alterations or misuse.

Electronic Notary Certificate Recommendations

State laws govern the appropriate content of a notary certificate for the various notarial acts. The certificate content may also vary depending on the state where the notarization is occurring. An electronic loan closing system should allow notaries to replace, edit and/or complete the text of the notary certificate for compliance with applicable law.

The Property Records Industry Association (PRIA) has published an XML DTD that defines basic data points generally utilized within notary certificates. Such data points combined with state-specific certificate text provide a "container" for electronic notary certificate data.

Conclusion

An electronic loan closing system must be designed to obtain a valid electronic signature of the notary in accordance with the requirements of ESIGN, UETA, URPERA and state notary laws or regulation.

References:

- American Bar Association (ABA) eTrust subcommittee on eNotarization https://www.abanet.org/dch/committee.cfm?com=ST231005&edit=1&CFID=9185943&CFTOKEN=66569594&jsessionid=f030a6a83456131777a5

3.5 Tamper-Evident Seal Guidelines

In order to preserve the integrity of an electronic document, one of the most common and reliable methods used today is the Tamper-Evident Seal (Digital Signature). It is the process of digitally signing a document with a valid certificate such that if a document is modified, the modification can be easily detected. In cases where the certificate references an individual or business entity, these digital signatures also provide proof of the identity of the signing party.

An eMortgage closing platform needs to ensure that:

1. A Tamper-Evident Seal Digital Signature is applied to a document after all other required signatures (electronic or digital) have been collected.
2. The certificate used to implement a Tamper-Evident Seal Digital Signature should be an organizational certificate obtained from a SISAC-accredited certificate issuer.
3. The date and time the signature was applied should be part of the signature.
4. The Tamper-Evident Seal Digital Signature should be part of the electronic document.

Applying a Tamper-Evident Seal Digital Signature to an electronic document consists of three steps. Steps 1 and 2 are performed by the creator/signer of the document. Step 3 is performed by the recipient of the electronic document.

1. Creating a hash value based upon the contents of the document using a mathematical function.
2. Encrypting this value with the private key which is a part of the certificate.
3. Creating a hash value based upon the contents of the document using the same mathematical function used in Step 1 and then comparing this value with the encrypted value after decrypting it using a public key provided by the creator/signer.

Electronic mortgage processes have the potential to be more secure than the paper processes because of mortgage industry standards such as the Tamper-Evident Seal. The seal is also a critical part of the MERS® eRegistry processes.

3.6 System Interfaces Guidelines

Introduction
In the paper-based closing environment, documents are sent to the settlement agent in a variety of formats that have evolved over time. Many lenders still ship the physical documents to the settlement agent using a courier, an overnight delivery servicer, or more recently electronically using web based interfaces. For those documents sent electronically, the settlement agent simply opens the document using a standard viewer (usually PDF) and prints them to a local printer. Aside from the minimal requirements of an appropriately configured personal computer and web access, the paper-based closing process imposes little technical expertise on the part of the lender or the settlement agent.

In this early stage of eMortgage adoption, existing electronic closing systems typically deploy proprietary interfaces for both document and data transmission to and from the settlement agent. This requires that the lender and the settlement agent have agreed on the specific technology solution to be used for a specific closing. This is manageable when the volumes of electronic closings between a lender and a settlement agent remain low. However, as volumes grow and as the number of lenders originating eNotes with multiple settlement agents grow, the propriety interface requirements become inefficient and difficult to manage.

It is critical for broad eMortgage adoption that lenders, settlement agents, and ultimately county recorders migrate to a common set of date interchange and document delivery standards such as those MISMO is providing.

To or From the Electronic Closing
Use of MISMO's data standards will enable document preparation vendors, loan origination system providers, electronic closing system platforms and title companies to exchange data before during and after the closing without having to re-key data or maintain multiple proprietary interfaces. As a best practice, the systems that send and receive these business critical messages, should store the messages for back up and recovery and dispute resolution purposes. These standards are being developed through the MISMO eMortgage Closing Interface Transactions (eMCIT) sub group.

MERS® eRegistry
This set of data standards was developed using the MISMO request/response message format so that lenders, electronic vaults, investors and servicers can register, transfer and service eNotes on the MERS eRegistry. For detailed information on these standards, visit www.mersinc.org and click on the MERS® eRegistry tab.

eDocument Delivery
These standards will reuse and modify the Transfer Request and Response messages and the MISMO Envelope & Packaging Specification currently used by the MERS® eRegistry for registration of eNotes and for transfers of Control, Location and Delegatee. For more information on these standards, see the MISMO eMortgage Guide.

eRecording
PRIA's eRecording and state and local eGovernment standards provide XML DTDs for standardized data exchange in the growing electronic recording and electronic notarization business processes. For more information on these standards, visit www.pria.us.

Conclusion
As eMortgage volumes grow and the number of trading partners multiply, standard, non proprietary interfaces for data transmission and eDocument delivery becomes essential for a secure, cost effective and efficient eMortgage infrastructure.

3.7 System Audit Trail Guidelines

Introduction
A closing system audit trail is an integral part of an electronic closing process or system. This type of audit trail is not a replacement for a traditional closing file containing either paper or electronic copies of receipts, disbursements, title policies, settlement statements and other documents that would need to be retained by a closing agent or the title company. Rather, a system audit trail would supplement the traditional closing file by capturing important events that occurred during an electronic loan closing session which may, from an evidentiary standpoint, be useful if the mortgage loan were subject to legal action. See section 3.1 of this Guide for a general legal discussion surrounding the evidentiary importance of an audit trail.

In a paper loan closing scenario, parties rely heavily on documentary evidence (i.e., the closing file, mortgage loan file checklists, closing instructions, written participant dates and signatures, etc.) and on participant recollection to re-create what occurred during a particular paper closing transaction. Participant recollection may not always be reliable especially when there is a large time gap between the loan closing and when participant recollection is required. In an electronic loan closing scenario, a system audit trail should be able provide a more reliable, less subjective record of events than participant recollection alone. This section describes some of the events that an electronic closing system audit trail should capture.

System Audit Trail Information
In general, an audit trail can be designed to answer "who, what, where, and when" types of questions. Information of this type that may be useful to record during an electronic closing includes:

- Uploading of documents to the electronic loan closing system, including date and time of upload.
- User log-in information to the electronic closing system, including date and time.
- Duration of loan closing session.
- Sign-out information, including date and time.
- Which documents in the electronic loan closing system were accessed, including date and time of access.
- How a particular document was handled within the loan closing system, including date and time of action:
    - Viewing;
    - Editing;
    - Initialing and signing;
    - Notarization;
    - Tamper-evident sealing;
    - Transferring document out of closing system; and
    - Time and date information for the above events.
- Who accessed and performed the above document handling events.

Preserving System Audit Trail Information

The system audit trail is only useful if the information can be accessed and retained by the party who actually needs to rely on this information. Therefore, lenders should consider ways in which they can access this information from the electronic loan closing system particularly in the situation where the system audit trail is controlled by a third-party vendor.

Conclusion

From an evidentiary standpoint, a system audit trail can provide valuable information as to what occurred during an electronic loan closing. Lenders need to keep in mind that audit trail information is only as good as the system that creates it. Before audit trail information can be relied upon, the lender must ensure that the information captured is the information that would be useful if needed and that the information is accessible for as long as a cause of action or claim may be brought with respect to the particular loan closed.

3.8 Electronic Records Storage Guidelines

Introduction
An eMortgage loan closing platform must be able to accept the delivery of electronic documents for execution during loan closing, securely store such documents, and return the documents electronically to the lender or other parties after execution and/or to the county recorder for recordation. This Section will focus on the safekeeping of electronic documents within an electronic loan closing platform using compliant records management policies, processes and procedures.

Guidelines
The eMortgage closing platform should be designed to follow compliant electronic records management policies, processes and procedures. Compliance policies, processes and procedures may be dictated by law, including ESIGN, UETA, federal and state laws and regulations on data security and record retention, and by lender, investor or title company requirements. See Section 3.1 of this Guide for a general legal discussion surrounding data security and record retention. Policies and procedures for secure storage of electronic records within a closing platform should be documented and adhered to during day-to-day operations. Such documentation may be requested by an independent auditor or law firm in the case of a Level 2 eMortgage closing system certification as described in Section 2.3. Such documentation may also be requested by an originator, lender, or title company to assist such parties with their due diligence review of an eMortgage closing platform. The following are general areas of electronic records management that should be part of the documentation:

1. Records declaration
    a. Records identifiers
    b. Associated metadata
2. Records capture
    a. Electronically delivered records
    b. Electronically signed records
    c. Imaged records
3. Records organization
    a. Relationship to a closing transaction
    b. Relationship to other records
    c. Versioning of the records
    d. Status tracking of the records
        i. Ex: Signed, recorded, other.
    e. Source of the records
        i. Ex: Lender, closing agent, title company, borrower, other.
4. Records security
5. Records retrieval
    a. Search
    b. Access
        i. Ex: View, print, copy, other.
6. Records preservation

a. Integrity of the records
b. Back up of the records

7. Audit trail
8. Final records disposition
   a. Destruction of the records
   b. Transfer of the records

Conclusion

Since an eMortgage closing platform handles and stores electronic records that contain sensitive consumer information, a platform should be designed to ensure the security and proper disposal of such information in accordance with any applicable laws. For companies involved in developing or selecting an eMortgage closing platform, they should develop or obtain documentation of a platform's electronic records management policies and procedures. Such documentation is also a requirement for all eMortgage closing platform certification levels.

References:

- The National Archives – Electronic Records Guidance
  http://www.archives.gov/records-mgmt/policy/prod6b.html

3.9 Security Guidelines

Introduction
An eMortgage closing system is a component of the overall mortgage process, and like all other components, it is required to comply with similar security policies, procedures, and controls applied to other components of the mortgage process. For example, the Gramm-Leach-Bliley Act ("GLB") requires the Financial Regulatory Agencies ("the Agencies") – including the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, the Securities and Exchange Commission, the Commodity Futures Trading Commission and the Federal Trade Commission - to establish standards, relating to safeguards, for the financial institutions subject to their jurisdiction. The safeguards are to ensure the security and confidentiality of customer records and information, and to protect against any anticipated threats or hazards to the security or integrity of those records. The safeguards are also to protect against unauthorized access to, or use of the records or information, that could result in harm to the customer. The Agencies have issued guidelines that establish standards for safeguarding customer information and are authorized to enforce these guidelines with respect to the financial institutions that fall under their jurisdiction.

Steps Your Organization Can Take
Organizations should take steps to protect their electronic closing environment. The biggest step your organization can take is acknowledging that data (both physical and logical) can be a critical asset, and that it needs to be managed and secured like any other critical asset within your organization. Next, every organization needs to understand that a solution for securing sensitive information (i.e., critical information assets) is not solely a technical solution, but one that involves people and processes as well. The MISMO Information Security Work Group (ISWG) has been promoting a general five-step security method in all of its security activities. This same five-step method, which is consistent with ISO 17799, can be used by any mortgage institution to identify, assess and safeguard information. This method is also useful in performing activities required to comply with industry regulations such as the Federal Trade Commission (FTC) Safeguards Rule as well as the various State legislations addressing notification requirements for security breaches involving disclosure of personal information.

In summary, this method involves:

- *Business and Risk Description* – Simply stated, the risk is not protecting sensitive information and the ramifications for not protecting that information are legislative and regulatory compliance. Business descriptions are use cases specific to your organization where sensitive information is handled. The ISWG has generally described these use cases as collecting, processing, transferring, storing and disposing sensitive information. Mortgage companies should use these general use cases to identify in more detail the use cases that are specific to their environment, where environment is defined as the physical environment (e.g.,

buildings, offices), the logical environment (e.g., networks), and the legal environment (e.g., security breach notification laws, consumer protection laws, required security audits). The result of this activity is a detailed understanding of where sensitive information exists and how it should be handled accordingly within your company.

- *Policy and Architecture* – This is the foundation for protecting sensitive information within your organization. The policy defines the high level requirements for securely managing information and in the case where a breach occurs, for providing incident response notification. The architecture is the framework for implementing specific technical and procedural solutions in support of your company's policy (e.g., segregation of responsibilities and infrastructure, interconnectivity).

- *People, Processes and Technology* – These are the detailed specifications for your organization to comply with your policy and to be implemented in accordance with your architecture. People need to be informed and trained on requirements for handling sensitive information; processes need to be put in place to ensure every individual and computer operates correctly with respect to the handling of sensitive information; and technology needs to be selected and implemented that provides the appropriate level of security (e.g., encryption, access control, auditing, intrusion detection, anti-virus, regulatory compliance).

- *Support Plan* – Information theft and the monitoring and notification of security breaches is an evolving landscape. Your organization should identify individuals who have a responsibility to keep up with this changing landscape (e.g., new laws, new information theft tactics, new security technologies and best practices). By keeping up with the changing landscape, your organization can adapt quickly and implement new solutions (or enhance existing solutions) for protecting your critical information assets. Business Continuity Plan/Disaster Recovery (BCP/DR), and maintenance plans (including change control) are elements of a Support Plan.

- *Education* – Education and awareness may be the single most important program your organization performs regarding the protection of sensitive information. The more your management, employees, contractors, etc. understand the importance for protecting sensitive information and the reputation benefits that can be gained by being an advocator of protected sensitive information, the more successful your organization will be in implementing information security solutions.

  If your company needs consultation services, there are many organizations (large and small) that can assist your company through the 5-step method above. Companies with expertise in or offering ISO 17799 compliance services are good candidates. It is highly recommended that you clearly define your initiative as protecting sensitive information and you should ensure that any consultants you hire are able to tailor their services appropriately.

Top 10 Electronic Closing Considerations

1. *If you don't have an information security program for your eMortgage Closing system, then one should be established.* If you have an existing program, then review and update the policies and procedures where appropriate to ensure they are adequately addressing the protection of your eMortgage Closing information assets. Information Technology (IT) personnel, Business Analysts, and Closing Agents, should all be involved in the review process. In addition, your human resources personnel may handle eMortgage Closing information as they perform their job functions, and the scope of those actions should be known to those reviewing your information security program. Finally, engage your Senior Management, as their involvement indicates high-level support for your information security program, which is critical to its success.

2. *Review the regulatory environment.* Regardless of whether you are regulated by the FTC, financial agencies (FRB, FDIC, etc.), SEC or some other body, there is an abundance of documentation available. Consult with your regulators, attorneys and auditors for compliance recommendations.

3. *Define sensitive information within your eMortgage Closing system.* Not all of the information processed is sensitive, either to your organization, your partner organizations, or to the individuals involved in the eMortgage process. Identify the sensitive data and the systems that process those information assets. A comprehensive understanding of the data, systems where the data traverses across, people and processes will enable your organization to establish appropriate security controls.

4. *Once sensitive information has been identified, assess the risk associated with an unauthorized disclosure of that information by exploring the likelihood and severity of unauthorized disclosure.* A risk assessment includes the examination of threats and vulnerabilities that could lead to the compromise of sensitive data.

5. *The primary concern of legislation and regulatory requirements is unauthorized access to sensitive or personal information.* Hence, access controls (e.g. user IDs, passwords, etc.) are critical aspects of a security program. Authentication procedures, privileges, and monitoring of users and systems (both production and test) are mandated requirements. Your organization should determine its authentication and access control requirements upon careful examination of your information assets and the risks associated with those information assets.

6. *Test, retest, and assess your eMortgage Closing system, as the environment surrounding your eMortgage Closing system is a dynamic one (e.g., changing regulatory requirements, technology requirements).* Good test plans include penetration testing as well as examining results when outages occur within certain critical components. For example, is the environment sufficiently layered to handle a situation when the firewall may fail? Organizations should also continuously perform maintenance (software patches, etc.) and monitor their

systems for security related events.

7. *Develop and maintain a security incident response plan.* Murphy's Law predicts that anything that can go wrong, will. It is recommended that the plan should minimally include monitoring, impact assessment, internal and external notification procedures, and a follow-up assessment.

8. *Understand the relationships with your business partners and third party service providers.* Any sensitive information collected, processed, stored, transferred, or disposed may legally be your responsibility. Verify that the minimum standards (policies and procedures) your organization places on information security are also mirrored by your partners. This may involve a contractual mechanism and assurance of a third party audit (e.g., SAS 70, ISO 17799 compliance).

9. *Encrypt sensitive data when appropriate.* If sensitive information is being transferred or stored, the data should be encrypted.

10. *Establish a comprehensive awareness program for all employees.* Even with all the appropriate technology in place, it often comes down to an individual employee to safeguard the sensitive information. As with system maintenance, education of information security is a never-ending activity. Roles, procedures, and resources change over time, and therefore organizations should schedule training at least annually.

Conclusion

Strong security is crucial to the operations of the electronic mortgage closing systems. Business partners are requiring third party assertion of regulatory compliance. Organizations will benefit from a SAS 70 or Trust Services audit or certification. There are a number of open sources that can be leveraged to aid in the establishment of a security program. Two such examples are the MISMO ISWG white paper on Identifying and Safeguarding Personal Information, which can be found at http://www.mismo.org and the MBA Board of Directors Technology Steering Committee white paper on Protecting Personal Information, which can be found at http://www.mortgagebankers.org.

4 Appendix

4.1 Reference Links

MBA	Mortgage Bankers Association www.mortgagebankers.org
MISMO	Mortgage Industry Standards Maintenance Organization www.mismo.org
MERS	Mortgage Electronic Registration System Inc. www.mersinc.org
PRIA	Property Records Industry Association. www.pria.us
SISAC	Secure Identity Services Accreditation Corporation. www.sisac.org
SPERS	Standards and Procedures for Electronic Records and Signatures. www.spers.org
NNA	National Notary Association www.nationalnotary.org
USNA	United States Notary Association www.enotary.org

4.2 Glossary

Authentication	A process of identifying an individual, either in connection with the creation of a relationship or in connection with the individual's participation in a transaction.
Authoritative Copy (AC)	The unique controlling reference copy of the Transferable Record (eNote), which is registered on the MERS eRegistry.
Certificate	A computer-based record or electronic file that, at least, states name or identifies the issuing Certificate, identifies the Subscriber, contains the Subscriber's public key, identifies the Certificate's Operational Period, contains a Certificate serial number, and is digitally signed by the Issuing Authority.
Control	A Person has control of a Transferable Record if a system employed for evidencing the transfer of interests in the Transferable Record reliably establishes that Person as the Person to which the Transferable Record was issued or transferred pursuant to Section 16 of UETA and Section 201 of ESIGN. For example, Control can be thought of as having possession of an original paper note.
Controller	The Person named on the MERS eRegistry that has Control of the eNote and its Authoritative Copy. For example, the Controller can be thought of as the "holder," "holder in due course," and/or "purchaser" of an original paper note as defined under the Uniform Commercial Code.
Delegatee	A member of the MERS eRegistry that is authorized by the Controller to perform certain MERS eRegistry transactions on the Controller's behalf.
Digital Certificate	A public key (or digital) certificate is a certificate that uses a digital signature to bind together a public key with an identity - information such as the name of a person or an organization, their address, and so forth. The certificate can be used to verify that a public key belongs to an individual or an organization.
Digital Signature	A cryptographic method of authenticating the identity of the sender of a message or the signer of a document that can also be used to ensure that the original content of the message or document has not been changed. Digital signatures are easily transportable, cannot be imitated by someone else, and can be automatically time-stamped. The ability to ensure that the original signed message was received means that the sender cannot easily repudiate it later.
Digitized signature	A handwritten signature that is converted upon execution into an electronic form. This is usually performed with a pen and a graphics drawing tablet used for sketching new images or tracing old ones. The user makes contact with the tablet with a pen or puck (mistakenly called a mouse) that is either wireless or connected to the tablet by a wire. For sketching, the user draws with the pen or puck and the screen cursor "draws" a corresponding image. This technology alone will not encrypt a document once signed.
DTD	Document Type Definition. A file that defines the "markup language" that will be used to describe the data. It defines and names the elements that can be used in the document, the order in which the elements can appear, the element attributes that can be used, and other document features.

Appendix - Glossary

Electronic Record	A record created, generated, sent, communicated, received, or stored by electronic means.
Electronic Signature	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	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.
eMortgage	A mortgage where the critical loan documentation – specifically the promissory note, assignments and security instrument, are created electronically, executed electronically, transferred electronically and ultimately stored electronically. AKA – the paperless mortgage.
eNote	A Transferable Record as defined by ESIGN or UETA, whichever is applicable.
eRecording	An act of registering the security instrument and other recordable documents electronically with the county recorder or similar jurisdictional authority".
eSecurity Instrument	An electronic security instrument such as a mortgage or deed of trust evidencing the pledge of real estate as collateral for the loan
Electronic Vault	An Electronic Vault is a transferable records management solution that meets ESIGN, UETA, and other compliance requirements. The concept is similar to a paper vault run by the document custodian industry today. Because there will be multiple Electronic Vaults, there is a need for national registry service (MERS® eRegistry) to manage the authoritativeness of records. In addition to the transferable records, the solution may support other types of eDocuments.
GSE	Government sponsored enterprise: Private organizations with government charters and backing. Examples are Freddie Mac and Fannie Mae.
HUD-1	Uniform settlement statement. Same as a closing statement.
Hybrid Transaction	A transaction in which the documents associated with the transaction are a combination of electronic records and paper-based documents.
Location (as it pertains to Transfer of Location)	The Person named on the MERS eRegistry that maintains the Authoritative Copy of the eNote either as Controller or as a custodian on behalf of the Controller.
LOS	Loan origination system.
MERS	Mortgage Electronic Registration Systems, Inc.
MERS® eRegistry	The MERS® eRegistry serves as the System of Record to identify the current Controller and Location of the Authoritative Copy of an eNote.

MIN	MERS Mortgage Identification Number. The MIN is an 18-digit number composed of a seven digit Organization ID, 10-digit sequence number, and check digit.
MISMO	Mortgage Industry Standards Maintenance Organization. The Mortgage Bankers Association (MBA) created the Organization in October 1999. The Mortgage Industry Standards Maintenance Organization's mission is to develop, promote, and maintain voluntary electronic commerce standards for the mortgage industry.
MOM	MERS as the Original Mortgagee. Language written into security instruments that establishes MERS as the Original Mortgagee and nominee for the Lender, its successors and assigns.
Person	An individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental agency, public corporation, or any other legal or commercial entity.
PKI	Public Key Infrastructure. A system that provides the basis for establishing and maintaining a trustworthy networking environment through the generation and distribution of keys and certificates. This is also the foundation technology for providing enhanced Internet security.
Secure Sockets Layer (SSL)	The industry-standard method for protecting Web communications developed by Netscape Communications Corporation. The SSL security protocol provides data encryption, server authentication, message integrity, and optional client authentication for a Transmission Control Protocol/Internet Protocol connection
SISAC	Secure Identity Services Accreditation Corporation. SISAC is responsible for accrediting digital identity credential issuers for the mortgage industry. SISAC is owned by the MBA.
SMART™ Document	An electronic document created to conform to a specification standardized by MISMO. A SMART Document locks together data and presentation in such a way that it can be system-validated to guarantee the integrity of the document.
System of Record	Authoritative System recognized to establish ownership and location of the Authoritative Copy of the eNote.
Tamper-evident seal	A "seal" wrapping an electronic document that is created by a digital signature. The seal can be verified to ensure that no changes have been made to the document since the seal was put in place.
Transferable Record	An Electronic Record under ESIGN and UETA that (1) would be a note under the Uniform Commercial Code if the Electronic Record were in writing; (2) the issuer of the Electronic Record expressly has agreed is a Transferable Record; and (3) for purposes of ESIGN, relates to a loan secured by real property. A Transferable Record is also referred to as an eNote.
UCC	Uniform Commercial Code.
UTC	Universal Time Coordinated. UTC is also referred to as GMT (Greenwich Mean Time) and is the global standard for time. All dates used by the MERS eRegistry will use UTC format.

W3C	World Wide Web Consortium. The World Wide Web Consortium was created to lead the World Wide Web to its full potential by developing common protocols that promote its evolution and ensure its interoperability.
X509	A standard for defining a Digital Certificate. It is the signing system used for SSL.
XHTML	Extensible Hypertext Markup Language. A family of current and future document types and modules that reproduce, subset, and extend HTML 4. XHTML family document types are XML based, and ultimately are designed to work in conjunction with XML-based user agents.
XML	Extensible Markup Language. XML is a markup language designed specifically for delivering information over the World Wide Web. In creating an XML document, the user creates and assigns the element names.

4.3 Index

For notes and comments

eMortgage Delivery

Frequently Asked Questions

March 2007

NOTE: For an explanation of terms used, refer to Section IV, eMortgage Terminology.

I. General Information

Q1. What is an eMortgage?

An eMortgage (electronic mortgage) is a mortgage for which the promissory note and possibly other documents (such as the security instrument and loan application) are created and stored electronically rather than by using traditional paper documentation that has a pen and ink signature. Because of the limited number of recording jurisdictions that accept electronic documents for recordation, most (but not all) eMortgages typically consist of a paper security instrument and an electronic note (eNote).

Q2. What is the legal basis for eMortgages?

The legal basis for eMortgages was established with the Electronic Signatures in Global and National Commerce Act (E-SIGN), enacted by Congress on June 30, 2000. Also, most states have adopted laws based on the Uniform Electronic Transactions Act (UETA), a model for state statutes that was developed in 1999 by the National Conference of Commissioners on Uniform State Laws. These laws prompted development of a legal infrastructure to support the creation of valid, enforceable, and transferable eMortgages, provided they comply with state and federal statutes governing electronic loan obligations and mortgage lending.

Q3. Does Fannie Mae purchase eMortgages?

Yes. Fannie Mae regards eMortgages as part of our normal business operations and is now purchasing eMortgages nearly every day. We are actively purchasing eMortgages that meet our published guidelines – through both whole loans and MBS executions. We purchased the first two eMortgages on the secondary market in 2000, and published a broad set of delivery guidelines in June 2002. In June 2005, we updated those specifications by publishing the *Guide to Delivering eMortgage Loans to Fannie Mae*, available on the eMortgage Delivery page of eFannieMae.com at www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/emtg/.

Q4. Are there industry standards for eMortgages?

Yes. The Mortgage Industry Standards Maintenance Organization (MISMO) eMortgage work group was formed in 2001 to develop standards for efficient eMortgage processes, transactions, and XML data protocol. Fannie Mae contributed to those efforts and developed the eMortgage Delivery application based on the resulting MISMO standards. The MISMO eMortgage Guidelines and Recommendations are available at www.mismo.org.

Q. 5 What are the anticipated benefits of eMortgages?

MISMO's *eMortgage Guide* suggests that the benefits of overall eMortgage process automation may include reduced cycle times, increased data integrity, lights-out processing, eventual cost savings in system integration, and reduced risk due to the electronic integration of compliance throughout the mortgage lending process.

With eMortgage Delivery, Fannie Mae offers a streamlined delivery-to-investor process alternative – and a ready secondary-market partner – for lenders that choose to create and deliver eMortgages.

Q6. Are lenders required to use a specific electronic closing (eClosing) system to deliver eMortgage loans to Fannie Mae?

No. Lenders may use any custom-built or off-the-shelf application; however, a review of the application and end-to-end testing are required to ensure compatibility with the MERS® eRegistry (see Section II) and with Fannie Mae's eMortgage Delivery requirements.

Q7. What type of mortgage loans can be delivered to Fannie Mae as eMortgages?

Most conventional first mortgages can be delivered to Fannie Mae as eMortgages. Possible exceptions include some products that require additional or special-purpose legal documents (such as Texas Section 50(a)(6) mortgages, HomeStyle® Construction-to-Permanent mortgages, refinance mortgages that are closed on our balloon loan refinancing instruments, reverse mortgages, and mortgages secured by Puerto Rico properties). Lenders who wish to deliver eMortgage loans for these products should contact their Customer Account Team member.

Q8. How are eMortgages serviced?

Generally, Fannie Mae's standard servicing requirements apply when servicing eMortgage loans. In addition, servicers must identify their eMortgages on their servicing systems. Servicers must have the capability to update the MERS eRegistry to record any payoff, charge-off, loan modification, or assumption. Prior to transferring servicing portfolios that contain eMortgages, the transferor servicer must ensure that the transferee servicer knows that there are eMortgages in the portfolio and is ready and able to service them. In the event of a foreclosure, there are special loss mitigation procedures servicers must follow, such as contacting their Fannie Mae Servicing Consultant and working with our designated attorneys.

Q9. When should lenders engage in conversations with settlement agents regarding their plans for eMortgages?

Prior to implementing an eMortgage initiative, lenders should engage in conversations with their settlement agents to identify settlement partners that are prepared to participate in eMortgage closings.

Q10. Where can I obtain more information about Fannie Mae's eMortgage Delivery offering?

Additional information on Fannie Mae's eMortgage Delivery can be found on eFannieMae.com at www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/emtg/.

Q11. How does a lender begin the eMortgage engagement process with Fannie Mae?

Lenders interested in undertaking an eMortgage initiative should contact their Fannie Mae Customer Account Manager or Business and Technology Consultant.

II. MERS – The Mortgage Electronic Registration System

Q12. What is the MERS® eRegistry?

The MERS eRegistry is the system of record identifying the owner and location of the electronic promissory note (eNote). The MERS eRegistry allows eNotes to be registered and uniquely identified for tracking and verification.

Q13. Is lender setup required to use the MERS eRegistry?

Yes. Lenders must become a MERS member to use the MERS eRegistry. Lenders can request a membership application from MERS by calling 800-646-MERS or downloading the application from www.mersinc.org. Access to the MERS eRegistry requires system integration and a testing cycle.

Q14. Are lenders required to use the MERS eRegistry for eMortgages delivered to Fannie Mae?

Fannie Mae's eMortgage Delivery technology and processes are integrated with the MERS eRegistry. Lenders are required to register the eNote on the MERS eRegistry immediately after closing. To deliver eMortgages to Fannie Mae, lenders must use MERS eDelivery to deliver the eNote and then must initiate a request with the MERS eRegistry to transfer ownership of the eNote to Fannie Mae.

Q15. Are servicers required to register with MERS?

Yes. We require a servicer to be reflected on the MERS eRegistry loan record as Delegatee to the Controller. As Delegatee, a servicer is required to update the MERS eRegistry with information on payoffs, charge-offs, loan modifications, and assumptions. Servicing Delegatees also are required to update the MERS eRegistry with a "Transfer of Delegatee Request" in the event of a servicing transfer of an eNote. Servicers should contact MERS for more information (www.mersinc.org).

III. eMortgage Delivery Process

Q16. What are the steps in the eMortgage Delivery process?

Although process details may vary, a high-level overview of the process for a lender delivering an eMortgage to Fannie Mae includes the following steps:

- eNote and possibly other documents are eSigned by the borrower and notary through the use of an eClosing system
- The eClosing system tamperseals the documents
- eNote is registered on MERS eRegistry within one business day
- Lender transmits eNote and other investor documents to Fannie Mae using MERS eDelivery
- Lender transfers control of eNote to Fannie Mae via MERS eRegistry
- Lender submits delivery data to Fannie Mae, including Special Feature Code 508 to identify the loan as an eMortgage
- Loan is certified and funded, assuming all requirements are met

Q17. What are the requirements for delivering eMortgages to Fannie Mae?

Standard Fannie Mae requirements regarding underwriting and eligibility for delivery to Fannie Mae apply to eMortgages. Additional eMortgage-specific delivery guidelines and technical requirements are contained in the *Guide to Delivering eMortgage Loans to Fannie Mae*, and *eMortgage Technical Requirements*, available at www.efanniemae.com/sf/guides/ssg/relatedsellinginfo/emtg/.

Q18. How are eMortgage documents protected and managed?

eMortgage documents are protected and managed through secure integration, document security standards, and the MERS eRegistry. Various security requirements and technologies are built into the eMortgage closing and delivery processes, including the use of tamperseals for electronic notes (eNotes). The MERS eRegistry provides a central industry registry to identify the Controller and Location of the uniquely identified single authoritative copy of the eNote at any moment in time.

Q19. What file format does Fannie Mae accept for eMortgages?

Fannie Mae currently accepts delivery of eNotes in the MISMO SMART Doc® format. Please refer to Fannie Mae's *eMortgage Technical Requirements* for details, available at www.efanniemae.com. Fannie Mae acknowledges recent industry developments in the area of electronic document signing. If you are interested in originating and delivering a signed eNote in PDF format or any other file format, please contact your Fannie Mae customer account team for information.

Q20. When do eNotes have to be registered with the MERS eRegistry?

All eNotes delivered to Fannie Mae must first have been registered in MERS eRegistry within one (1) business day of signing. The record in the MERS eRegistry must reflect the originating lender – the lender whose name is on the eNote – as the first Controller. Any and all subsequent transfers of the eNotes – changes of Control – must be reflected in the MERS eRegistry.

Q21. What is a MIN and how is it used?

A MIN is an 18-digit MERS "Mortgage Identification Number," an industry-standard eMortgage numbering system used to identify the eMortgage registered with the MERS eRegistry. Each eMortgage has a unique MIN that is used by the MERS eRegistry and the MERS Assignment System.

Q22. What is the Transfer of Control process for delivering the eNote to Fannie Mae?

Using an API (Application Programming Interface), lenders transmit a "Transfer of Control and Location" request (or a "Transfer of Control Only" request if Fannie Mae will not be holding the Authoritative Copy) to the MERS eRegistry to begin the Transfer of Control process of the eNote to Fannie Mae. Upon Fannie Mae's receipt of the "Pending Transfer Request" message from the MERS eRegistry, the eMortgage Delivery application will seek to match the transfer request against eNotes delivered to the application. Fannie Mae will accept the transfer request from the MERS eRegistry once the match is made and the validation is complete.

Q23. What types of electronic signatures are acceptable to Fannie Mae?

Fannie Mae accepts all eSignatures that meet E-SIGN requirements except those created by sound or video. The most common forms of electronic signatures are typed (or click) signatures, digitized signatures, and digital signatures. If a digitized signature is used, such as a holographic signature created with a signing pad, the signature must be attached as an external file, which may be in either a .jpg or .gif file format.

IV. eMORTGAGE TERMINOLOGY

Q24. What is the SMART Doc® format?

The SMART Doc format is an industry standard developed by MISMO that locks data and presentation together in a way that can be system-validated to help maintain the integrity of the document. The SMART acronym stands for Securable, Manageable, Archivable, Retrievable, and Transferable. All eNotes delivered to Fannie Mae must be in SMART Doc, Category One format.

Q25. What is an "Authoritative Copy" of the note?

An Authoritative Copy is the unique controlling reference copy of the Transferable Record (eNote), which is registered on the MERS eRegistry.

Q26. What is a Tamperseal?

A tamperseal is a "seal" wrapping an electronic document that has been digitally signed. The seal will provide evidence of any changes made after it is put in place.

Q27. What is E-SIGN?

E-SIGN – the Electronic Signatures in Global and National Commerce Act – was enacted by Congress in June 2000 to facilitate the use of electronic records and signatures by ensuring the validity and legal effect of contracts entered into electronically. E-SIGN imposes special requirements on parties that want to use electronic records.

Q28. What is an eNote?

An eNote is an electronic transferable promissory note – the electronic equivalent of a negotiable paper promissory note. It is created, signed, and stored as an electronic document in an electronic vault (eVault) by a custodian.

Q29. What is an eVault?

eVaults have been created to store eNotes. An eVault is a transferable records management solution that meets legal requirements and industry standards created by MISMO.

FREDDIE MAC eMORTGAGE HANDBOOK

Version 1.0

Requirements for Participating in Freddie Mac's eMortgage Initiative

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NOTICE

This Electronic Mortgage Handbook ("Handbook") has been prepared by Freddie Mac for its Seller/Servicers that enter into negotiated agreements with Freddie Mac to originate and sell electronic Mortgages to Freddie Mac. Electronic Mortgages ("eMortgages") are Mortgages that have an electronic Note ("eNote"). An eMortgage may also have an electronic Security Instrument and certain other electronic mortgage file documents. If a Seller enters into a negotiated agreement with Freddie Mac to sell eMortgages, the requirements contained herein will be incorporated into and become a part of the negotiated agreement and will amend and supplement the Freddie Mac *Single-Family Seller/Servicer Guide* ("Guide") and Seller/Servicer's other Purchase Documents. The requirements in this Handbook are subject to revision by Freddie Mac at any time at its sole discretion. Notwithstanding anything contained in the Guide or Seller/Servicer's other Purchase Documents to the contrary, any such revision shall be effective as of the date specified by Freddie Mac. The information contained in this Handbook is not a statement of law and does not create any rights in any Seller/Servicer or any other party.

Section 1 Introduction

The *Freddie Mac eMortgage Handbook*, when incorporated into Seller/Servicer's other Purchase Documents, sets forth Freddie Mac's requirements for Seller/Servicers that wish to originate and sell eligible eMortgages to Freddie Mac. This Handbook replaces and supercedes, in its entirety, the Freddie Mac *Preliminary Specifications for Electronic Mortgage Loan Documentation* published in 2001 and made available to the mortgage industry.

1.1 Contents

This Handbook addresses the following important issues related to creating and selling eMortgages to Freddie Mac:

Section 2 – eMortgage Setup Requirements

- What you need to know to become eligible to sell eMortgages to Freddie-Mac
- Data Privacy requirements
- Technical and non-technical requirements for Sellers/Servicers, Custodians, Notaries Public, and Systems Providers involved in the eMortgage closing process.

Section 3 – eCustodian Eligibility Requirements

- What you need to know to become a Freddie-Mac-approved eCustodian
- Requirements for setting up, operating, and maintaining an eMortgage Vault

Section 4 – Origination Requirements

- Freddie Mac requirements for obtaining consent from Borrowers and other consumers in eMortgage transactions
- Title insurance requirements for eMortgages
- Electronic Signature requirements

Section 5 – Electronic Records Maintenance and Administration of Records for Freddie Mac

- How to maintain electronic documents with Electronic Signatures
- Required electronic formats for eMortgage File documents
- Use of tamper-evident seals
- Requirements for document quality and storage
- Definition of and standards for maintaining hybrid loan files
- Requirements for maintaining electronic documents in Mortgage Files that are not required to be held by an eCustodian
- Rules for inspection of electronic Mortgage Files
- Requirements for transfers of custody of electronic Mortgage Files and eNotes.

Section 6 – Delivery

- How to certify eNotes
- Documents required to be delivered to the eCustodian by the Seller
- Instructions for holding eNotes, eNote Modifications, and Security Instruments
- Requirements for using the MERSCORP, Inc. Note Holder Registry to register eNotes, execute transfers to Freddie Mac, and record other actions
- Requirements for eNote Modifications, including certifying and registering these documents in the MERSCORP, Inc. Note Holder Registry
- Requirements for modifying Security Instruments for counties that cannot record electronic Security Instruments.

Section 7 – Servicing Requirements

- How to effect Transfers of Servicing
- Requirements for access to custodial documents
- Requirements for assumptions of eMortgages
- Requirements for eMortgage deeds-in-lieu of foreclosures, foreclosures, and payoffs.

1.2 Intent

This Handbook is intended to provide Seller/Servicers, Custodians, System Providers, and other mortgage industry participants with Freddie Mac's requirements for creating eMortgages that are eligible for sale to Freddie Mac. It is also intended that publishing this Handbook demonstrate Freddie Mac's continued support of the mortgage industry's goal of moving from paper documents to electronic documents in a manner that is prudent and consistent with safe and sound practices.

1.3 Interpreting Requirements Set Forth in this Handbook

In addition to the requirements set forth in this Handbook for eligible eMortgages, the Seller/Servicer's negotiated Purchase Documents may include supplemental requirements. Seller/Servicers and Custodians will be required to make certain representations and warranties regarding their compliance with requirements in this Handbook and in other agreements, as applicable.

1.4 Conventions

Capitalized terms used herein shall have the meaning ascribed to such terms in Appendix B: Glossary of Terms of this Handbook, the Freddie Mac *Single-Family Seller/Servicer Guide*, Seller's other Purchase Documents, E-SIGN, and UETA.

1.5 Background

The requirements and specifications of this Handbook are based on the requirements of the federal Electronic Signatures in Global and National Commerce Act (E-SIGN), adopted by Congress and signed into law by the President in 2000, and the Uniform Electronic Transactions Act (UETA), adopted by the

National Conference of Commissioners on Uniform State Laws (NCCUSL) and recommended for adoption by the 50 states, the District of Columbia, U.S. possessions and territories in 1999.

E-SIGN and UETA put Electronic Records and Electronic Signatures on an equal footing with paper-based documents and written signatures. E-SIGN and UETA were designed to be technology neutral that is, they were drafted and adopted as general enabling acts that leave the choice of technology to the parties relying upon these laws. These new laws do not have interpretive rules, or regulations, although the model UETA does contain prefatory notes and commentary. Until case law interpreting E-SIGN and the UETA, as enacted in any particular jurisdiction, has developed, the mortgage industry will need to promulgate standards to support the mortgage industry's use of eMortgages.

Section 2 eMortgage Setup Requirements

This section addresses requirements for key participants involved in the eMortgage loan closing process.

2.1 Complying with Freddie Mac Requirements

Participants in an eMortgage loan closing process using an electronic mortgage closing system, electronic vault, or other system concerning the creation, registration, transfer, storage, retrieval, maintenance, and security of the eNotes must comply with the requirements specified in this Handbook. In addition, contracts for services provided in connection with the creation, registration, transfer, storage, retrieval, maintenance, and security of eNotes will be required to incorporate certain terms and conditions.

2.1.1 Selling eMortgages to Freddie Mac

Seller/Servicers who wish to sell eMortgages to Freddie Mac should contact their Account Manager to begin the process of determining their ability and readiness to originate and sell eligible eMortgages to Freddie Mac. Seller/Servicers that have been approved by Freddie Mac to sell eligible eMortgages to Freddie Mac and whose Purchase Documents have been amended by appropriate negotiated contract language must comply with all of the requirements in their amended Purchase Documents, including the requirements in this Handbook.

2.1.1.1 Seller/Servicer Representations and Warranties

In addition to making all applicable representations and warranties in the *Single-Family Seller/Servicer Guide* and Seller/Servicer's other Purchase Documents, each Seller/Servicer selling eMortgages to Freddie Mac represents and warrants to Freddie Mac that:

- Any Electronic Record that is intended to constitute an eNote is a Transferable Record, and the eNote and the Systems used to create, register, transfer, store, retrieve, maintain, and secure the eNote, comply with all requirements under E-SIGN and/or UETA, as enacted by the applicable jurisdiction, including, without limitation, Section 201 of Title II of E-SIGN and Section 16 of the applicable UETA, and any other applicable laws.
- Any other Electronic Records in the electronic Mortgage File, and the Systems used to create, record, transfer, store, retrieve, maintain, and/or secure such Electronic Records, comply with all applicable laws, regulations, and rules and applicable requirements in this Handbook.
- The Electronic Signature process employed by the System used to create the Electronic Signature complies with all legal requirements under E-SIGN and/or UETA, as enacted by the applicable jurisdiction, including, without limitation, Section 201 of Title II of E-SIGN and Section 16 of the applicable UETA, and any other applicable laws, regulations, and rules, and applicable requirements in this Handbook.
- The consumer pre-consent disclosures and the Consumer Consent Form used by the Seller/Servicer to obtain the Borrower's and any other applicable consumer's (co-borrower, property owner, property seller) consent to engage in an eMortgage transaction comply with Section 101 of Title I of E-SIGN and all other applicable state and federal laws, regulations, and rules, and applicable requirements in this Handbook.
- Each and every eMortgage sold to Freddie Mac is in compliance with all applicable laws, regulations, and rules and is a valid, enforceable, and effective first lien on the Mortgaged Premises.
- Seller/Servicer will at all times comply with all applicable laws, regulations and rules, all applicable requirements in this Handbook and the System Rules in the Systems used to create, register, transfer,

store, retrieve, maintain, and secure the eNote for each eMortgage, and, if applicable, any other electronic Mortgage File documents.

- Seller/Servicer will use a Freddie Mac authorized eNote form with the required changes as set forth in Appendix A: Authorized Uniform Instruments and Required Changes to Uniform Instruments of this Handbook.
- Seller/Servicer will not sell any eMortgages to Freddie Mac that are Texas equity First Lien Refinance Mortgages originated under section 50(a)(6) of Article XVI of the Texas Constitution.
- Seller/Servicer will ensure that before the Borrower signs and the tamper-evident seal is applied to any MISMO Category 1 SMART Document securing a loan intended for sale to Freddie Mac, the data in the View section matches the data in the Data section.

2.1.1.1.1 Custodian Selection and Use of Multiple Custodians

Seller/Servicer must select an electronic Document Custodian (eCustodian) that meets the eligibility requirements described in Section 3 of this Handbook. Freddie Mac Document Custodial Services (DCS) will not certify or store eNotes.

Seller/Servicer may only deliver eNotes to a Custodian approved by Freddie Mac to be an eCustodian. The eCustodian selected by Seller and approved by Freddie Mac to hold Freddie Mac's eNotes may be a different entity than the entity that Seller and Freddie Mac use to hold Freddie Mac's paper Notes. Freddie Mac prohibits multiple Custodians from holding documents (paper or electronic) from the same loan file.

2.1.1.1.2 Custodian Agreement Process

Before delivering or transferring an eNote to an eCustodian on behalf of Freddie Mac, the Seller/Servicer, the eligible eCustodian, and Freddie Mac must enter into an eCustodial Agreement (Form 1035), which includes an amendment with special requirements for eNotes.

2.1.1.1.3 Special Requirements for Selling and Servicing eNotes

In addition to negotiating a special eMortgage agreement to sell eMortgages to Freddie Mac and complying with the requirements of Section 2.1.1, the Seller/Servicer must comply with the following special selling requirements:

- Seller/Servicer must sell all eMortgages through the Freddie Mac Selling System.
- Seller/Servicer must insert special characteristics code (SCC) #251 in one of the special characteristics code fields in the Selling System for each eMortgage sold to Freddie Mac.
- Seller/Servicer must close each eMortgage with MERS® as Original Mortgagee of Record (OMR) and register the eMortgage on the MERS® System prior to Freddie Mac purchasing the loan.
- Seller/Servicer must deliver a Certified Copy of the Authoritative Copy of the eNote to Freddie Mac (characterized by the tamper-evident digital signature matching the MERSCORP, Inc. Note Holder Registry) in addition to the Form 11 (Mortgage Submission Schedule for fixed-rate Mortgages and Balloon/Reset Mortgages).
- Seller/Servicer must agree to a means of documenting whether or not an eNote is being sold "with recourse" or "without recourse" in a manner that is: (i) legally comparable to the manner prescribed in the model UCC Article 3, Section 3-415 and (ii) acceptable to Freddie Mac, in its sole discretion.

- Seller/Servicer must make, and document, transfer warranties to Freddie Mac and its successors and assigns that are: (i) comparable to the transfer warranties in the model UCC Article 3, Section 3-416 and (ii) in a manner acceptable to Freddie Mac, in its sole discretion.
- Seller/Servicer must transfer the eNote to an eligible eCustodian (see Section 3 for custodian eligibility requirements).
- Seller/Servicer must immediately register each eNote intended for sale to Freddie Mac with MERSCORP, Inc. a Delaware corporation, as the Note Holder Registry, but in no event later than 24 hours after closing of the eMortgage.
- eCustodian must hold the eNote in an electronic storage system ("eMortgage Vault") that meets Freddie Mac's requirements (refer to Section 3.1.2.2 for eMortgage Vault requirements).
- Seller/Servicer may not transfer the servicing of an eMortgage to a Servicer that has not been expressly approved by Freddie Mac to Service eMortgages.
- Seller/Servicer may not sell Mortgages to Freddie Mac in which the eNote has been converted to a paper-based Note without getting Freddie Mac's specific and express written consent.

In addition to negotiating a special eMortgage agreement to service eMortgages for Freddie Mac, the Seller/Servicer must comply with the following special servicing requirements:

- Seller/Servicer must be able to perform all of the functions related to servicing eMortgages through the full life-of-the-loan of the eMortgage, including modifications, assumptions, changes to the eNotes, releases and satisfactions, foreclosures, etc.
- Seller/Servicer must identify all eMortgages in its servicing system as eMortgages and apprise its staff of any special Freddie Mac eMortgage servicing requirements.
- Seller/Servicer must be able to perform all appropriate transactions with the MERSCORP, Inc. Note Holder Registry to ensure that events during the life-of-the-loan are properly processed, and, if necessary, registered in the Note Holder Registry (refer to Section 6.2 for MERS guidance).
- Neither the Seller/Servicer nor the eCustodian may convert an eNote to a paper-based Note without obtaining Freddie Mac's specific and express written consent. Conversion of an eNote to a paper-based Note is solely at the discretion of Freddie Mac.

2.1.1.1.4 Data Privacy

For purposes of this Section, the term "Sensitive Private Information" means any "non-public personal information" as defined in the Gramm-Leach-Bliley Act as well as any information that is subject to any other federal, state, and local laws governing or relating to data privacy or the safeguarding of personal information. For example (and without limiting the foregoing), "Sensitive Private Information" often includes an individual's name, address, or telephone number, in conjunction with one or more of the following: his or her social security number, driver's license number, or account number.

Seller/Servicer represents and warrants that it will comply with any provisions of the Gramm-Leach-Bliley Act, its implementing regulations, and other federal, state, and local laws governing or relating to data privacy or the safeguarding of personal information that are applicable to the parties or to Sensitive Private Information related to loans owned by Freddie Mac. Further, Seller/Servicer represents and warrants that it will undertake such reasonable actions as may be required to enable Freddie Mac to comply with such laws and regulations.

Seller/Servicer will promptly notify Freddie Mac when Seller/Servicer learns of an event (1) affecting Sensitive Personal Information related to loans that Seller/Servicer is servicing on behalf of Freddie Mac and (2) that Seller/Servicer believes is likely to trigger a notice obligation under any federal, state or local

laws that require notices of the unauthorized acquisition or misuse of personal information (a "Security Breach"), such as but not limited to the California law known as SB 1386. Seller/Servicer will cooperate with Freddie Mac in connection with any such Security Breach and will provide all information and assistance reasonably requested by Freddie Mac in connection with Freddie Mac's due diligence inquiry into the event. In conducting any due diligence inquiry into Security Breaches related to Seller/Servicer's systems or facilities, Freddie Mac will make a good faith effort to coordinate with any of Seller/Servicer's ongoing investigation/remediation efforts that meet or exceed industry standards so as to avoid unnecessary duplication of or undue interference with Seller/Servicers' efforts. If both Freddie Mac and Seller/Servicer are required to notify affected individuals following a Security Breach, Freddie Mac and Seller/Servicer will discuss whether it would be appropriate and feasible to provide a single form of notice. In addition, Seller/Servicer will give Freddie Mac reasonable advance notice if Seller/Servicer intends or is required to provide notices that identify Freddie Mac or could lead to a belief that Freddie Mac was involved in the Security Breach. Without limiting any other rights or remedies that may be available to Freddie Mac, Seller/Servicer will reimburse Freddie Mac for the reasonable costs and expenses Freddie Mac incurs as a result of each Security Breach involving Sensitive Personal Information under Seller/Servicer's control.

Seller/Servicer will ensure that all other parties to which it discloses Sensitive Private Information comply with the requirements of this Section. Seller/Servicer will be liable to Freddie Mac for the failure of any such parties to comply with such requirements.

2.1.2 Notary Public

At present, few counties are ready to accept electronic Security Instruments for recording. As a consequence, most eMortgage transactions for the foreseeable future will most likely only have an eNote and possibly other electronic Mortgage File documents. The Security Instrument, in most cases, will continue to be a paper document for some time. As most Security Instruments will be paper documents, the Borrower's signature on the Security Instrument will be a traditional written signature and the notary public's acknowledgement of the Borrower's written signature on a Security Instrument will be a traditional written acknowledgement.

2.1.2.1 Electronic Notarization of Electronic Documents

Freddie Mac will not accept remote or automated notarization equivalents as a substitute for the personal appearance of the Borrower before the notary public at loan settlement under any condition.

The System Provider providing an electronic notarization System must comply with all laws, regulations, and rules to assure that an electronic notarization of an electronic Mortgage document is effective, valid, enforceable, and complies with applicable law. Paper records that currently require notarization will continue to require notarization even if they are replaced with Electronic Records.

The Seller/Servicer must represent and warrant that the System being used to facilitate the electronic notarization process complies with the requirements for Electronic Signatures under E-SIGN, the applicable UETA, and other applicable laws.

The Electronic Signature requirements set forth in Section 4.3 will also apply to the notary public's Electronic Signature.

Section 3 eCustodian Eligibility Requirements

This section addresses Freddie Mac's eligibility criteria to become an eCustodian and requirements for eMortgage Vault System Providers, including the eMortgage Vault.

3.1 Becoming an eCustodian

A Custodian that desires to become a Freddie-Mac approved eCustodian must be selected and recommended by a Freddie-Mac approved Seller/Servicer, which must submit a document custodian application to Freddie Mac's Document Custodian Eligibility Unit. Freddie Mac will determine, based upon the information provided, whether or not the Custodian meets Freddie Mac's minimum requirements to be an eCustodian on its behalf. The information that must provided to Freddie Mac includes, but is not necessarily limited to:

- The legal opinion as specified in Section 3.1.2
- The technical review results as specified in Section 3.1.2
- An eCustodian application addendum/questionnaire.

Freddie Mac may conduct an on-site interview to analyze and assess the Custodian's qualifications to be an eCustodian.

3.1.1 eCustodian Requirements

Before delivering an eNote that has been sold to Freddie Mac to a Freddie-Mac approved eCustodian, the Seller/Servicer must deliver to Freddie Mac a Custodial Agreement (Form 1035) amended by an eNote custody amendment to the Custodial Agreement prepared by Freddie Mac (collectively, the "eCustodial Agreement") that has been executed by the Seller/Servicer and an approved eCustodian.

The eCustodial Agreement by and among the Seller/Servicer, eCustodian, and Freddie Mac shall include, among other things, the eCustodian's agreement that:

- The eCustodian has no property interest whatsoever in the Freddie Mac eNotes and any other electronic Mortgage File documents (or the data that is contained therein) that are stored in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided the eCustodian's System Provider) and will not use, rent, lease, barter, sell, or in any other way allow others to use the data for any purpose whatsoever, whether the data is in the aggregate and/or is anonymous, without Freddie Mac's express written consent.
- The eCustodian will not take any action or pursue or enforce any remedy that prevents Freddie Mac (or Seller/Servicer on Freddie Mac's behalf) from taking any and all actions that an owner of the eNotes may take, including, without limitation: (i) pursuing legal action under the eNotes; (ii) foreclosing under the Security Instruments securing the eNotes; (iii) defending against any legal actions brought in connection with any of the eNotes or the respective Security Instruments; (iv) settling disputes or claims in connection with any of the eNotes or the respective Security Instruments; (v) modifying , amending or restating the eNotes; (vi) canceling the eNotes; (vii) transferring the eNotes and any other electronic Mortgage File documents; and (viii) viewing or printing the eNotes and any other electronic Mortgage File documents that are stored in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided by the eCustodian's System Provider).
- The eCustodian shall make eNotes and any other electronic Mortgage File documents owned by Freddie Mac that are stored in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided

by the eCustodian's System Provider) available to Freddie Mac, Seller/Servicer, or the Borrower as requested by Freddie Mac or the Seller/Servicer.

- Notwithstanding any disputes that may arise between or among the eCustodian, the eCustodian's System Provider, Freddie Mac or the Seller/Servicer, including, without limitation: (i) any claims of breach of agreement; (ii) disputes over payment for services rendered, software licenses, custodial services, any other products or services; or (iii) any other disputed matter whatsoever, Freddie Mac (or Seller/Servicer on Freddie Mac's behalf) has an unconditional and absolute right, as owner of the eNotes and any other electronic Mortgage File documents stored in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided by the eCustodian's System Provider) to have the eCustodian transfer Freddie Mac's eNotes and other electronic Mortgage File documents to another eMortgage Vault of Freddie Mac's choice, at any time and at its sole discretion.
- The eCustodian shall promptly transfer Freddie Mac's eNotes and any other electronic Mortgage File documents in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided by the eCustodian's System Provider) at Freddie Mac's direction and in accordance with its instructions and the requirements of this Handbook, as amended from time to time.
- Freddie Mac (or Seller/Servicer on Freddie Mac's behalf) may enforce Freddie Mac's rights set forth above to have the eCustodian promptly transfer Freddie Mac's eNotes or to provide read-only access to and print capability of Freddie Mac's eNotes and any other electronic Mortgage File documents that are stored in the eCustodian's eMortgage Vault (or in an eMortgage Vault provided by the eCustodian's System Provider) as set forth above, in an action for specific performance, there being no other suitable remedy.
- Any agreement between the eCustodian and any System Provider under which the System Provider makes its System (eMortgage Vault) available to the eCustodian for the storage and maintenance of Freddie Mac's eNotes and any other electronic Mortgage File documents shall be consistent with the provisions of the eCustodial Agreement.

3.1.1.1 Annual Document Custodian Eligibility Certification Report

As indicated in the Form 1035 and eCustodian Amendment, all approved eCustodians must submit an Annual Document Custodian Eligibility Certification with an eCustodian Certification Addendum. The Certification provides a means for eCustodians to certify compliance with the requirements of this Handbook and requirements contained in the *Single-Family Seller/Servicer Guide.* The certification will also require the eCustodian to inform Freddie Mac of the primary and backup data hosting site(s) where eNotes are held.

3.1.1.2 Freddie Mac Termination of the Custodial Agreement

At its sole discretion, Freddie Mac may, following 30 days written notice to the Seller/Servicer and the eCustodian (or such shorter time as may be permitted under Form 1035 and the *Single-Family Seller/Servicer Guide*), terminate the Custodial Agreement and require the Seller/Servicer to cause all eNotes held by the eCustodian to be transferred within 30 days after the approval by Freddie Mac to another eCustodian. See Section 7.1.1 for additional guidance on this process.

3.1.2 System Requirements

The following is a list of requirements specific to eMortgage activities to which an eCustodian must comply in addition to complying with the eligibility requirements listed above and set forth in the *Single-Family Seller/Servicer Guide.* The eCustodian must:

- Provide a legal opinion from a law firm with a specialty in eCommerce and computer/Internet technology law and that is recognized nationally in the mortgage industry as having expertise with respect to E-SIGN and UETA and electronic notes and Mortgages that concludes the technology solution used to store the eNotes, as it relates to the storage and ongoing maintenance of electronic signatures and documents, meets the minimum requirements of E-SIGN and the UETA, including, without limitation, Section 201of Title II of E-SIGN and Section 16 of the model UETA, and any other applicable state and federal laws and does not jeopardize any safe harbor afforded by these laws. If an eCustodian uses a System Provider for the eNote storage technology solution, the System Provider may obtain the legal opinion, provided there are no material modifications to the system as implemented at the eCustodian's site that would compromise the validity of the opinion. Whether obtained by the eCustodian or vendor, the opinion shall be addressed to and run to both the Custodian and Freddie Mac.
- Provide a technical analysis from an independent third-party technology expert recognized nationally in the mortgage industry as having expertise with respect to eNote storage systems that confirms the storage system used by the Custodian meets MISMO and Freddie Mac's standards and requirements.
- Maintain systems and security that comply with requirements described in Section 3.1.2.2.
- Following the guidance in Section 2.1.1.1.4, contact Freddie Mac upon learning of any occasion, event, or incident that exposes the security of the technical solution or the confidentiality, integrity, and enforceability of the eMortgage Files owned by Freddie Mac.

3.1.2.1 eCustodian Use of Vendor Software, Hardware, and Services

Freddie Mac allows the use of third-party vendors to provide technical solutions for the storage of eNotes. The following terms apply to any such relationships:

- Freddie Mac does not prescribe the use of particular vendor solutions, nor do we approve vendors. The Seller/Servicer and eCustodian remain responsible for the adequacy of the systems and compliance with all guidelines and requirements under this document and any other such requirements Freddie Mac may issue governing the use of eNotes.
- The eCustodian must conduct proper and adequate due diligence regarding the capability of each System Provider and eMortgage Vault to store the eNotes safely and soundly. Prudent business practices dictate the use of contracts that specify obligations of performance and a process to confirm that such obligations are being met. As a Seller/Servicer or eCustodian, you should implement processes and controls that allow you to make that determination.
- All contracts between the eCustodian and third-party eMortgage Vault providers must specify that eMortgage Vault providers will comply with eCustodian instructions to send any Electronic Documents or Electronic Records required by Freddie Mac to Freddie Mac upon request, notwithstanding any dispute the system provider has with the contracting party.
- Permanent or contingent staff (i.e., temporary employees and consultants) of the eCustodian must perform responsibilities and duties of the eCustodian.
- Any data storage facilities used by the eCustodian or provided by the vendor must be domiciled in the United States.
- The eCustodian must ensure that any outsourced vendor systems comply with the Sarbanes-Oxley Act of 2002 and all other applicable laws.

3.1.2.2 Technical and Security Requirements for Custodian Information Systems

The eCustodian must use a secure electronic storage system – commonly referred to as the eMortgage Vault – for safekeeping of the eNote on the investor's behalf. The Custodian information system (System) mentioned in this Handbook is an aggregate of systems supporting eCustodian functions. This System must have electronic document transfer, processing, and integration capabilities with, but not limited to, other Custodians', MERS, and investors' systems. The eCustodian can either build such systems in-house, or purchase or license third-party vendor products (including software, hardware, and services) that provide corresponding capabilities.

3.1.2.2.1 System Audit Requirements

The eCustodian must conduct a system audit and generate a transactions audit trail to ensure the System's continued compliance with the minimum system and security requirements outlined here, which may be frequently updated to accommodate the rapidly developing standards supporting eMortgage transactions. The audit type and frequency will be negotiated and included in the Custodial Agreement but must be a SAS 70 Type II, SysTrust, or WebTrust audit as described by the American Accounting Industry. The results of such audit will be provided to each Freddie Mac Servicer and to Freddie Mac within 30 days of its completion and delivery to the eCustodian. The audit will serve as proof that the System meets the following Freddie-Mac required system and security controls:

- Prohibit co-mingling of assets
- Securely accept electronic documents
- Support original electronic document versions
- Interface with the MERS® eRegistry
- Transfer electronic documents to other custodians
- Authenticate users
- Support role-based access control and prevent unauthorized access
- Execute users, groups, and security policy
- Verify system integrity
- Verify document integrity and detect document alteration
- Validate eMortgage Vault tamper-evident seals
- Safeguard confidentiality of data in transit and at rest
- Audit significant events

In addition to assessing System security controls, the audit will evaluate compliance with Freddie-Mac required physical security controls as follows:

- Data center
- Backup and business continuity

3.1.2.2.2 System Security Requirements

The System must be capable of performing the activities described below to comply with Freddie Mac audit requirements.

Exclude Co-mingling of Assets

eCustodians must separate and segregate all eNotes and other electronic Mortgage File documents belonging to Freddie Mac and the data contained in such electronic documents stored in their in-house system or in a System Provider's storage System (eMortgage Vault) from any other party's eNotes, other electronic Mortgage File documents, and data. Freddie Mac's eNotes and other electronic Mortgage File documents and the data contained in such electronic documents that are stored in the eMortgage Vault must be promptly and clearly identifiable as Freddie-Mac owned eNotes, other electronic Mortgage File documents, and data contained in such electronic documents. Co-mingling of Freddie Mac's eNotes, other electronic Mortgage File documents, and data contained in such electronic documents with any other party's eNotes, other electronic Mortgage File documents, and data is strictly prohibited.

Securely Accept Electronic Documents

The eCustodian's System must support multiple means of electronic document and data delivery as specified in Section 5 of this Handbook. At a minimum, the System must be able to:

- Securely receive electronic custodial documents as described in Section 5.2.
- Use SISAC-recommended X.509 digital certificates for device/server-based TLS/SSL session authentication. Mutual authentication is recommended but not required. The digital certificate must support at least 128-bit data encryption for the TLS/SSL session to ensure data confidentiality and integrity during transit.
- Acknowledge the success or failure of the eNote transfer to sending systems, and have logging and reporting capabilities for eNote transfer events.
- Logically associate any riders, addenda, or other modifying instruments, whether electronic or paper, with the eNote using the MIN and/or Freddie Mac loan number.

Specifications on integration with Freddie Mac systems will be published at a future date.

Support Original Electronic Documents Version

The System must be able to support the MISMO industry standard version in which the electronic document was originally created. This includes but is not limited to the MISMO SMART Document Specification version as well as the Logical Data Set specification version used to create the document. This support must span the entire life of the document held within the eMortgage Vault. For any software used for the creation or storage of the electronic document (including the eMortgage Vault), the eCustodian must ensure the integrity of the software by following industry best practices and processes for software version changes and testing, retirement, and control.

Interface with the MERS® eRegistry

The *MISMO eVault Implementation Guide 1.0* provides both required and suggested eMortgage Vault system interface capabilities with the MERS® eRegistry. Refer to MERS® eRegistry published detailed system integration requirements (http://www.mersinc.org) for more information about transactions with MERS.

Transfer Electronic Documents to Other Custodians

The System must have the capability to transfer eNotes and other electronic Mortgage Files documents from one eCustodian eMortgage Vault to another. The System must support assets transferability (eMortgage Vault-to-eMortgage Vault) transactions that maintain the confidentiality, integrity, and enforceability of eMortgage assets from one eMortgage Vault to another. At a minimum, requesting or

submitting party identifier, eNote or eMortgage File to be transferred, and Transferee eCustodian system identifier need to be included in the transfer request, and the System must track transfer success or failure.

The MISMO eVault Working Group and MERS are developing additional standards on eNotes and other eMortgage File transfers between eMortgage Vaults. Freddie Mac will also publish more detailed guidance as standards in this area become clearer.

Authenticate Users

The System must support one or more authentication methods, e.g., user ID/password, X509 digital certificate, and biometrics. Freddie Mac recommends the use of SISAC-accredited Issuing Authority individual or organizational digital certificates.

If the System is using user ID/password for user authentication, the eCustodian or System Provider must impose a strong password construction policy. For example, the policy must require a minimum of at least two of the following in every password: lowercase letters, uppercase letters, special characters, and numbers. The policy might also enforce a minimum password length of eight characters, and restrict the use of common "weak" passwords such as user IDs, last names, dictionary words, etc.

The System must support password aging and enforce password change and store user passwords in encrypted form.

eCustodians must follow best practices to distribute user IDs and credentials to users. For example, if using email, two separate emails must be used, one for the user ID and another for the password. The System must force users to reset password upon initial login.

Support Role-Based Access Control and Prevent Unauthorized Access

The System must support role-based access control to eNotes and their supporting documents. The System must feature tiered access and permission to have detailed and flexible access control over user permission levels.

The System must be able to detect and block unauthorized access requests, log such events, and alert operational staff of failed access attempts.

The System must implement session management techniques to prevent unauthorized users from establishing a valid Session ID and accessing any resources within the application. A user's Session ID must be destroyed either due to an active logout from the application or due to predetermined system timeout parameters.

Execute Users, Groups, and Security Policy

The eCustodian must establish request and approval processes and procedures for granting access rights to eNotes, their supporting documents, and other custodian services provided by the System.

The System must support:

- CRUD (Create, Read, Update, Delete) activities on users, groups, protected resources, roles, access rights, and policies
- Distributed and remote administration functions (the eCustodian or System Provider must provide the support model and policies to transaction parties)
- Immediate removal of a user or role from the System if it is no longer authorized to access the System or service.

Verify System Integrity

The System must provide the following protections:

- Virus, worm, and other destructive software detection and removal
- Appropriate firewall and network protection provisions
- Intrusion detection.

Verify Document Integrity and Detect Document Alteration

The System must have the capability to verify document integrity including, but not limited to, compliance with eNote DTD or schema and eNote tamper-evident seal before accepting third-party submissions into the eCustodian systems.

The System must be able to verify tamper-evident digital signatures applied to eNotes by:

- Checking the Certificate Revocation List (CRL) for revoked digital certificates
- Updating CRL per SISAC guidelines; the local CRL list on the eCustodian's local systems should be periodically updated to obtain new updated lists from major providers
- Checking certificate status protocol (OCSP); the OCSP may be used to validate certificates in real-time (live connection to OCSP service needed
- Verifying SISAC-approved issuer; root certificates for certificates and tamper-evident digital signatures must be issued by SISAC-approved providers
- Comparing the eNote tamper-evident digital signature in the MERS® eRegistry by comparing the hash value of the eNote in the incoming package with the hash value of the same eNote as registered in the MERS® eRegistry.

The System must be able to check eNote tamper-evident digital signatures on demand or in batch mode.

The System must be capable of handling consequences resulting from invalid tamper-evident digital signatures that:

- Reject document submission and notify document submission party of invalid tamper-evident seal
- Recover uncorrupted from backup devices if the current data is determined to be invalid
- Notify controller or controller's system that the eNote's tamper-evident digital signature has been determined to be invalid
- Record the tamper-evident digital signature validation in an event log for audit purposes.

The System must use a SISAC-approved CA issued organizational digital certificate to perform digital signing when conducting transactions with the MERS® eRegistry.

The System must have the capability to apply a tamper-evident digital signature to a specific eMortgage File during eMortgage Vault-to-eMortgage Vault transfers.

The System must validate the entire certificate chain on eMortgage Vault-to-eMortgage Vault transfers.

Validate eMortgage Vault Tamper-evident Seals

Freddie Mac requires the following types of tamper-evident seal validation:

Internal Validation. Freddie Mac requires eMortgage Vaults to validate the tamper-evident seal for all stored, tamper-sealed documents at least once a year. eCustodians must retain a backup of the validated documents until the next validation occurs. Additionally, the tamper-evident seal must be validated for

any documents affected by the restoration or partial restoration of an eMortgage Vault's underlying databases.

External Validation with MERS. Freddie Mac requires eMortgage Vaults to validate the tamper-evident seal for a sampling of all stored eNotes against the MERS® eRegistry once a year. Freddie Mac and the eMortgage Vault provider will determine the required sampling percentage during contract negotiations.

Safeguard Confidentiality of Data In Transit and Data At Rest

The eCustodian must follow the data privacy protection guidance specified in Section 2.1.1.1.4 of this Handbook.

The eCustodian must classify data based on confidentiality levels specified by the industry and investors, and prevent unauthorized viewing of the most sensitive data and documents through restricted access.

Recommended best practices for protecting confidentiality of data include:

- Establish an encrypted channel (e.g., HTTPS, SFTP, FTPS) for the transmission of the most sensitive data
- Encrypt the most sensitive data before transmission over an insecure channel. Use and support National Institute of Standards and Technology (NIST) and Federal Information Processing Standard (FIPS) specified encryption algorithms – for example, AES (Advanced Encryption Standard) and 3DES – as encryption algorithms.
- Encrypt the most sensitive data before storing it in a persistent store (e.g., encrypting a file or database)
- Generate a message digest for password value and storing it in a persistent store for subsequent comparison for validation
- Separate administrative responsibilities of encryption key management from those of system management.

Audit Significant Events

The System must be able to audit significant security events such as authentication, authorization, and administration activities to allow the review of actions that were performed by users in a secured environment.

The System must track eNote receipt and processing events, including receipts and communication between eMortgage Vaults.

The System must track all communication initiated to and received from MERS® eRegistry transactions.

3.1.2.2.3 Physical Security Requirements

The eCustodian must provide for the physical security of its eMortgage Vault and its contents as described below to comply with Freddie Mac audit requirements.

Data Center

The eCustodian's records management system on which the eNotes reside must be hosted in an industry strength data center. The data center must employ the highest level of physical security in definition and practice addressing access control, surveillance, fire suppression, water detection, etc. for eNotes. Minimum requirements for the data center include:

- Discrete building signage

- Building entrances and exits that are monitored for unauthorized access and activities
- Two forms of authentication for entry of authorized staff to the data center, such as photo ID scan card and either a biometric device or a number keypad
- Additional authorization verification for access to the vault area
- Commercially reasonable physical security for all other electronic documentation
- 24 hour, 7 day a week operation (allowing downtime for upgrades, maintenance, and repairs)
- Redundant primary Systems (power, connectivity) and sub-systems (HVAC, telecommunications) and appropriate back-up capabilities (battery power, generator).

Backup and Business Continuity

The eCustodian must back up eNotes and related documents on a regular basis. The eCustodian must maintain backup and recovery systems of electronic assets through the management of the Authoritative Copy of the eNote and at least two backup copies that are stored in a system that meets or exceeds Freddie Mac's requirements for a primary eNote storage system. Freddie Mac reserves the right to maintain a copy of all electronic Mortgage File documents for all Mortgages that it has purchased.

Security access control to backup tapes and other backup media must be part of the overall custodian system security policies and practices.

The System must restore archived/backup materials within 24 hours of a request. In case of data corruption, archived data must be restored to the point of failure within 10 minutes.

The eCustodian must have at least one geographically remote disaster recovery site in addition to the primary site for its production systems. All technical, security, and physical site requirements for the primary site apply to the disaster recovery site.

The eCustodian must have a documented Business Continuity Plan (BCP) to recover functionality, availability, and data to the point of failure within 48 hours of a declared disaster or other event requiring the activation of a BCP. The eCustodian shall provide a copy of the BCP promptly upon Freddie Mac's request. The eCustodian's BCP shall address at a minimum:

- Staff responsibilities, including on-call availability, etc.
- Location of and transportation to a backup facility with access security, power backup and fire prevention and containment measures at least equal to that of the primary site
- Communication and business continuity activation programs
- Notification to Freddie Mac DCS within 24 hours of determining that a disaster has impacted the eCustodian's site and/or that a change to the physical location of the primary site of the eCustodian and associated documentation and data will continue for more than two business days
- Security for storage, testing, and recovery
- Software versioning, replacement, and retirement/control.

Section 4 Origination Requirements

This section addresses the following Freddie Mac requirements for eMortgage origination:

- Consumer Consent for Electronic Records and Electronic Signatures that will be used in lieu of paper and pen and ink written signatures
- Title insurance
- Electronic signatures
- Borrower access to eNote.

4.1 Obtaining Consumer Consent

Consent must be obtained on an electronic consent form ("Consumer Consent Form") that is electronically signed by the Borrower and all other applicable Consumers whenever any disclosure is provided electronically that would otherwise be required by law to be provided in writing, including but not limited to Notes with disclosures, HUD 1 statements, and Truth-In-Lending disclosure statements. After all applicable Consumers have electronically signed the Consumer Consent Form, the Consumer Consent Form must be securely stored with the other electronic Mortgage File documents.

The process used to permit a Consumer to electronically sign the Consumer Consent Form must ensure the same level of integrity as the Electronic Signature process used to permit a Consumer to electronically sign the eNote. The process must employ one of the approved electronic signature methods outlined in Section 4.3, and the signed document must be tamper-sealed. The Consumer Consent Form must (i) be voluntary and (ii) comply with E-SIGN and other applicable laws and regulations.

4.1.1 Who Must Give their Express Consent

Express consent must be obtained electronically from anyone participating in the residential mortgage loan transaction that is a Consumer as that term is defined in E-SIGN, immediately preceding the electronic closing. At a minimum, all Borrowers, co-borrowers and persons with an interest in the property that must sign the Note, Security Instrument or deed of conveyance must consent electronically by electronically signing an electronic Consumer Consent Form that the originating lender has provided to the System Provider.

4.1.2 Requirements for Consumer Pre-Consent Disclosure

Each participant who is involved in an electronic residential mortgage loan transaction as a Consumer, as that term is defined in E-SIGN, or as attorney-in-fact for a Consumer, must be provided a pre-consent "conspicuous disclosure" by electronic means. Procedures for consumer pre-consent disclosure must comply with E-SIGN and any other applicable laws and regulations. The pre-consent disclosure must meet all applicable legal requirements for conspicuousness.

4.1.3 Use of Power of Attorney for Consent

In a hardship or emergency situation, Freddie Mac will permit the Note, Security Instrument, and other closing documents to be executed by a person acting as attorney-in-fact pursuant to authority granted by a Borrower under a power of attorney. The person acting as attorney-in-fact should have a familial, personal, or fiduciary relationship with the Borrower.

The Seller may permit an attorney-in-fact to consent on behalf of the Consumer granting the power under a power of attorney (POA) provided that: (i) it is permitted by applicable law; and (ii) Seller is

responsible for determining that the terms of the POA are sufficient to establish a delegation of the authority to the attorney-in-fact to consent on behalf of the Consumer.

4.1.4 Manner of Consent for Parties Other than Consumers

Each Person (other than a Consumer) who participates in an electronic residential mortgage loan transaction must give their consent to conduct the transaction electronically, although such consent may be implied. The Seller/Servicer represents and warrants to Freddie Mac that each person that has participated in an electronic residential mortgage loan transaction has consented to conduct the transaction electronically.

4.1.5 Timing of Consent

Even though a Consumer has given his or her consent before on a date preceding the loan closing date, the originating lender must obtain the Consumer's express consent on the loan closing date preceding the eMortgage closing process.

4.2 Title Insurance Requirements for eMortgages

Each Mortgage purchased by Freddie Mac must comply with the title insurance requirements set forth in the *Single-Family Seller/Servicer Guide*, as amended and supplemented by this Handbook.

For Mortgages that have eNotes, the title insurance policy must be written on one of the eligible Title Insurance Loan Policy Forms set forth in the *Single-Family Seller/Servicer Guide*.

In particular, the Title Insurance Loan Policy Form used must not take exception for any matters related to the fact that the promissory Note secured by the Security Instrument is an electronic Note.

In addition, regardless of which eligible loan policy form that Seller uses, the loan policy must provide affirmative coverage insuring that the first lien status of the Security Instrument is not adversely affected in any way due to the fact that the promissory Note secured by the Security Instrument is an electronic Note and that the first lien Security Instrument is valid, effective and enforceable first lien.

4.3 Electronic Signatures (eSignatures)

Consumers must give their express consent to conduct an electronic residential mortgage transaction by executing an electronic consent form provided by the originating lender and certain other Electronic Records using an Electronic Signature that is attached to or logically associated with the Electronic Record and signed or adopted by a Person with the intent to sign the Electronic Record.

The originating lender must assure that necessary parties to the electronic residential mortgage loan transaction adopt secure and enforceable Electronic Signatures. Systems that create or accommodate Electronic Signatures must be designed to comply with the requirements set forth in this section.

The Procedure used to create an Electronic Signature must address all of the following:

- The signer's authority to sign the Electronic Record
- The signer's intent to sign the Electronic Record
- Attaching the Electronic Signature to or associating the Electronic Signature with the Electronic Record to be signed
- The symbol or Process being used as an Electronic Signature
- The method or process for attributing the signature to the signer

- Ensuring that each Electronic Record has been individually reviewed, electronically signed, and has had the Electronic Signatures attached to or associated with the Electronic Record before moving on to the next Electronic Record.

4.3.1 Authority to Sign

When the originating lender obtains Electronic Signatures it must comply with all substantive legal requirements with respect to establishing the authority of the Person signing to sign: (i) on their own behalf; (ii) on behalf of others (such as an attorney-in-fact); or (iii) in a representative capacity (such as a corporate officer or trustee), as applicable under the circumstances. If a Person is signing is in a representative capacity, the Electronic Signature must be structured to reflect the name of the Person actually signing, the represented Person, and the signer's title or capacity. If permitted under applicable law, documents establishing authority to sign on behalf of others may be:

- In the form of an Electronic Record, and
- Signed using an Electronic Signature.

In addition to complying with any other legal or Freddie Mac requirements, establishing the authority to sign must include the following:

- For individuals signing on their own behalf:
  - A Procedure for establishing the signer's identity, and
  - A Procedure for establishing the signer's capacity to contract under applicable law, including a commercially reasonable effort to determine that the signer is not a minor or legally incompetent.
- For individuals signing on behalf of another or in a representative capacity:
  - A Procedure for establishing the signer's identity,
  - A Procedure for establishing the signer's capacity to contract, and
  - A Procedure for establishing the appropriate delegation of authority by the represented Person and the represented Person's capacity to delegate. In the case of a power of attorney, the power of attorney should clearly establish, as appropriate, whether the attorney in fact is empowered to sign on behalf of the represented Person, or whether the attorney in fact is empowered to attach the represented Person's Electronic Signature to or logically associate the represented Person's Electronic Signature with the Electronic Record on behalf of the represented Person.

4.3.2 Evidence of the Intent to Sign

The Process for obtaining an Electronic Signature must be designed to demonstrate that the signer intended to sign the document. Establishing intent includes a number of elements, including:

- Establishing the intent to use an Electronic Signature
- Identifying the reason the signer is signing the Electronic Record
- Assuring that the signer knows which Electronic Record is being signed.

4.3.2.1 Intent to Use an Electronic Signature

In an electronic environment, care should be taken to provide reasonable certainty that a signer is aware of the signature process and its legal consequences. This may be particularly significant with Consumer transactions during the initial stages of the conversion to Electronic Records, since many Procedures may not be as familiar to the Consumer as the traditional Procedures associated with paper documents and written signatures. Therefore, the signature process must be designed to provide:

- Notice to the signer that an Electronic Signature is about to be (or has just been) attached to or logically associated with the Electronic Record
- Evidence of the signer's intent to have the signer's Electronic Signature attached to or logically associated with the Electronic Record.

Because the signature process may involve introductory or explanatory material, or information dialog boxes and other notices that may change over time, the Seller/Servicer and the System Provider must maintain these materials for archival purposes and later reference.

4.3.2.2 Establishing the Reason for the Electronic Signature

The System or Process must be designed to provide notice to the signer of the purpose the Electronic Signature will serve. Purposes an Electronic Signature may serve include, but are not limited to, evidencing:

- The signer's consent to participate in an electronic transaction
- The signer's agreement to the terms of the Electronic Record
- The signer's receipt of the Electronic Record
- That the signer had a chance to review the Electronic Record
- That the signer is the Person sending the Electronic Record.

There are a wide variety of ways in which a signer may be made aware of the purpose a signature will serve. In many cases, the purpose is apparent from the surrounding circumstances. In other cases, current practice includes a statement in the written documents, above the signature line or elsewhere, giving notice of the legal effect the signature will have.

4.3.3 Identifying the Electronic Record to Be Signed

The System or Process must be designed so that each Electronic Record, that is required to be signed by the Consumer by law or by another party to the transaction, is separately presented to the signer for signature. Attaching the Electronic Signature to or logically associating the Electronic Signature with each Electronic Record shall require a separate affirmative act by the signer.

The definition of signature under both E-SIGN and UETA requires an intention to sign. Freddie Mac will not purchase an eMortgage in which the Consumer's electronic signature has been automatically attached to or logically associated with a whole series of Electronic Records.

4.3.4 Signature Attached to or Logically Associated with Electronic Record

The System or Process must be designed so that an Electronic Signature is attached to or logically associated with the Electronic Record intended to be signed to the extent necessary to comply with E-SIGN and/or UETA enacted by the applicable jurisdiction or other applicable state law. In addition, when an authorized party to an electronic transaction is reviewing an electronically signed Electronic Record, the party must be able to promptly and reasonably determine: (i) the signer's Electronic Signature has been attached to or logically associated with the Electronic Record, (ii) the type of Electronic Signature symbol or Process used, and (iii) the identity of the signer.

Where a signature Process has been used instead of a symbol (as, for example, with a password and PIN used to access a Record), the Electronic Records within the System should contain, incorporate, or be clearly associated with, the identity of the signer and a description of the signature Process that was employed.

4.3.5 Symbol or Process Used As an Electronic Signature

Freddie Mac requires Seller/Servicers to represent and warrant that the type of Electronic Signature used by the Borrower to sign the eNote, and any other Electronic Record associated with the transaction, is legally enforceable under applicable law and is not effected by means of the following:

- Audio or video recording
- Object signatures such as biometrics or specialized signing pads and/or applets.

Both E-SIGN and UETA permit the use of symbols and identification processes as Electronic Signatures. The type of signature being used, in any particular instance, may be dictated by the technology choices made by the software vendor, or the circumstances of the transaction, or the preferences of the participating parties. In addition, with respect to documents to be filed of record with government authorities, the regulations established by the authority may dictate the choice of signature methodology. Refer to Section 5 for types of signatures acceptable to Freddie Mac and for what documents and under what circumstances, etc.

4.3.6 Attribution

"Attribution" is the process of associating the identity of a signer with the signature. In order to be enforceable, the Electronic Signature must be attributable to the Person who has purportedly signed the Electronic Record. The Person obtaining a signature must establish a high level of confidence, appropriate to the gravity of the transaction, that the signer will not be able to effectively deny signing the Electronic Record at a later date.

In general, the Person attempting to enforce an Electronic Record bears the risk that the authenticity of a signature will be challenged. Attribution may be established by notarization, witnesses to the signing, and the circumstances surrounding the transaction. In many cases, the circumstances surrounding the transaction are such that a later claim that an Electronic Record was not reviewed and signed will lack credibility. The level of effort put into establishing attribution can appropriately be varied according to the circumstances and gravity of the transaction.

In addition, Freddie Mac requires the following stipulations to be implemented by all systems processing eSignature requests:

- The signing process must, at a minimum, implement the following:
  - Individually authenticate each signer
  - Notify the signer when he or she initiates an eSignature request.
  - Clearly explain the implications that result from signing the document
  - Prompt the signer to confirm his or her eSignature request.
- Each document must be individually reviewed, signed, and modified by affixing all required signatures prior to moving on to the next document.
- When reviewing the signed Electronic Record, it must be possible to determine the existence of the associated eSignature, the type of eSignature, the process employed, and the identity of the signer.
- Signature must include signer's name, date, and timestamp.

4.3.7 eNote Signatures

For eNote signatures, Freddie Mac requires the following in addition to the eSignature requirements stated in Section 4.3:

- All signing parties must be physically present in the electronic closing location for the electronic Signing process.
- Signers must validate their credentials in the closing System by entering their user IDs and passwords at the outset of the eSignature process to indicate their desire to electronically sign the documents and again before they sign the documents.
- Seller represents and warrants that the map section of the eNote MISMO Category 1 SMART Document that contains the relationships and links between the data section and the view section, including information on the related conversions, if any, is accurate.

4.3.8 Other Electronic Documents

Freddie Mac requires the Consumer Consent Form and all electronic legal documents to follow the same eSignature requirements as eNotes, while non-legal documents must follow the eSignature requirements in Section 5.3.

4.4 Borrower Access to eNote

By law, the Borrower must have access to the eNote. This requirement can be met by providing a paper copy or, if the Consumer agrees, providing an electronic copy. For more information, refer to Section 7.1.2.

Section 5 Electronic Records Maintenance and Administration of Records for Freddie Mac

This section sets forth requirements for the electronic maintenance and administration of mortgage documents for Freddie Mac, where these Mortgages are supported, in part or in full, by electronic documents. The following guidelines apply to eMortgage loans closed and delivered to Freddie Mac and serviced for Freddie Mac.

5.1 Maintaining Electronic Documents with Electronic Signatures

For all eMortgage loan documents for which an Electronic Signature is obtained, Freddie Mac requires that these documents be maintained in a manner that preserves the integrity of the Electronic Record and Electronic Signature. These documents must follow the guidelines indicated in Section 5.3.

For electronic mortgage loan documents without electronic signatures, the *Single-Family Seller/Servicer Guide* and its policies apply.

5.2 Additional Requirements for Specific Electronic Mortgage File Documents

The following electronic Mortgage loan documents must be created in a manner that provides assurance that (i) the document is digitally signed and secured by tamper-evident seals, and (ii) the view and data portions of the document are inextricably linked. At present, MISMO Category 1 SMART Documents are the only document formats approved by Freddie Mac that provide this level of assurance.

- Promissory note (authoritative copy), addenda, and the primary back-up copy
- Security Instrument and riders, if applicable
- Modifying instruments, if applicable
- Assumption instruments, if applicable
- HUD 1
- Title Insurance Policy – Short Form

The following electronic Mortgage File documents must include a view, digital signature, data, and tamper-evident seal. These components must follow MISMO data standards. For these documents, the view and data portions do not need to be inextricably linked.

- Appraisal
- Uniform Residential Loan Application (URLA)
- Title Insurance Policy – Long Form
- Title Insurance Binder
- Credit documents, including credit reports and Loan Prospector Feedback/Certificate
- Completed Uniform Underwriting Transmittal Summary Form 1077

5.3 Tamper-Evident Digital Signatures (Tamper-Evident Seals)

Freddie Mac requires that all tamper-evident digital signatures (tamper-evident seals) on loan documents comply with the following rules:

- Freddie Mac will only accept tamper-evident seals utilizing industry standard, recognized, W3C compliant, and MISMO-approved digital signature algorithms with X.509 certificates issued by a SISAC-accredited Issuing Authority (for eNotes, exceptions to the SISAC-accredited Issuing Authority requirement may be negotiated on a case-by-case basis).
- **For eNotes:** Tamper-evident seals must comply with specifications for tamper-evident signatures with authentication as defined in the MISMO *SMART Document Implementation Guide*.
- **Other Documents that require tamper seals and eMortgage Files:** Because the authenticity of the Tamper Seal cannot be validated with MERS, authentication is required and must comply with specifications in the MISMO *SMART Document Implementation Guide*.

  Freddie Mac requires eNote tamper-evident seals to be stored in the MERS® eRegistry. This digital signature will be the primary means Freddie Mac uses to authenticate an eNote's tamper-evident seal. Because an equivalent MERS functionality does not exist for other tamper-sealed loan documents, Freddie Mac will rely on certificates issued by a SISAC-accredited Issuing Authority as the primary means to authenticate the tamper-evident seal.

5.3.1 Additional Display and Formatting Rules

Electronic records that are used to provide information and obtain signatures in lieu of paper documents must include all of the substantive terms and conditions contained in the written documents. In addition, all applicable formatting rules must be observed.

Any legal requirements concerning the content, display, or format of information if it were in writing must be observed both with respect to electronic display of the Electronic Record and printing of the Electronic Record. Neither UETA nor E-SIGN eliminates any existing display or formatting requirements. As an illustration only, some of the formatting and display requirements that must be observed are:

- Use of specific fonts, specific type sizes, minimum type sizes, and boldface or italic styling
- Physical location of particular information, such as disclosures that are required to appear just above the place for signature
- Requirements that information be boxed, or segregated, or separately displayed.

If specific or separate legal requirements concerning content or format of the information have been established for Electronic Records by the controlling legislative or regulatory authority, those requirements must be observed.

5.3.2 File Formats

File formats for Electronic Records must be capable of accurately reproducing the fonts, styling, margins, and other physical features of the Electronic Record both when being electronically displayed and in print. Pagination, line spacing, and paragraph formatting and numbering must all be maintained unless approved electronic form versions are used. On-screen viewing of the Electronic Records must be possible either through means of proprietary programs developed by System Providers or through open data formatting standards, provided the software is offered through widely available methods such as an Internet browser or software that is free to the public (for example, Adobe Acrobat Reader) and not subject to licensing conditions that would limit Freddie Mac from using these documents for any reason whatsoever.

5.3.2.1 No Limitations on Usage

For all documents, regardless of format, the Seller/Servicer represents and warrants that the documents must be maintainable, reproducible, and have no licensing conditions that would limit Freddie Mac from using these documents for any reason whatsoever.

5.3.2.2 Self-Contained

Electronically signed Electronic Records must contain all of the information necessary to reproduce the entire Electronic Record and all associated signatures in a form that permits the Person viewing or printing the file to verify:

- The contents of the Electronic Record
- The method used to sign the Electronic Record, if applicable
- The Person or Persons signing the Electronic Record and the capacity in which they signed.

5.3.3 Document Resolution

For delivered images, should Freddie Mac deem that document image quality is below standards, Freddie Mac reserves the right to require paper equivalents. If a pattern of poor quality is identified, Freddie Mac reserves the right to dictate minimum standards to which the Seller/Servicer must adhere. If a document is deemed to be unreadable, Seller/Servicer must produce the original or the document is considered missing.

5.3.4 Document Storage

Unless otherwise directed, the Servicer and other parties must adhere to the file retention policies as specified in the *Single-Family Seller/Servicer Guide.*

5.4 Hybrid Transactions and Documentation

5.4.1 Hybrid Transactions

Freddie Mac defines a hybrid loan transaction as any such Mortgage loan transaction where the loan documents (see Section 5.2) are a combination of paper and electronic records. Likewise, a hybrid loan file is any loan file where the loan documents are a combination of paper and electronic records.

5.4.2 Hybrid Loan Documentation Standards

Freddie Mac will allow the Seller/Servicer and eCustodian to maintain their requisite loan file documentation in a combination of paper and electronic formats, as long as appropriate cross-references are maintained. However, where business processes dictate a specific format, parties will be expected to deliver the required document format in accordance with Freddie Mac requirements.

5.4.3 Hybrid Records Management

If the origination files and servicing files or any other documents for an electronic Mortgage are in a hybrid format (e.g., some are paper and some are electronic), then the paper portion of the files must be retained following requirements of the *Single-Family Seller/Servicer Guide*, and the electronic portion of the files must follow the guidance set forth in this section. The electronic files and paper files pertaining to a specific Mortgage must be cross-referenced based on requirements set forth in Section 6.1.1.1 of this Handbook.

5.5 Electronic Records Management of Non-Custodial Documents

This section describes electronic records management requirements for all Mortgage Files excluding documents that are required by Freddie Mac to be held by approved document custodians. Servicers and any contractually obligated parties who hold Mortgage Files on Freddie Mac's behalf can use either an in-house-built or third-party-vendor electronic records storage and management system for Mortgage File retention.

5.5.1 Contents

Servicers must maintain all documents, as defined in the *Single-Family Seller/Servicer Guide*, for each Mortgage serviced for Freddie Mac.

5.5.2 Retention of Electronic Format

All documents in the electronic file must either retain their original electronic file format, or if created in paper form and permitted by the *Single-Family Seller/Servicer Guide*, be imaged based on Freddie Mac approved imaging standards as defined in Section 5 of this Handbook.

Servicers are required to conduct periodical system and information security reviews based on, but not limited to E-SIGN, UETA, and SPeRS provisions, standards, and procedures affecting Electronic Record retention.

5.5.3 Electronic Document Integrity

Servicers, at a minimum, must establish a request and approval process to grant role-based access rights to electronic Mortgage File records in their systems.

The records management system must have user authentication and role-based access control capability, and must track and log user identity, action performed (view, modify, delete, etc.) on records, and time of the event.

The records management system must detect and block unauthorized access and alteration of eMortgage Files, and to alert Servicers if unauthorized attempts exceed pre-configured thresholds.

Freddie Mac reserves the right to impose additional security measures, for example, the application of tamper-evident seals to electronic documents, as deemed necessary in the future.

5.5.4 Electronic Data Privacy Protection

Servicers must follow data privacy protection standards as outlined in Section 2.1.1.1.4 of this Handbook. Servicers are also required to follow federal and state privacy protection laws and regulations, as well as regulatory agencies' (i.e., Federal Reserve Bank, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision, as applicable) continued guidance and advisories on privacy protection of consumer data, and the best practices on the safety and soundness of their systems.

5.5.5 Maintenance of Mortgage Files

In addition to providing controls and identification features as specified in the *Single-Family Seller/Servicer Guide*, Servicers must:

- Provide viewing, retrieving, and printing capabilities for these documents in accordance with Purchase Document requirements regardless of the electronic formats in which Mortgage Files and records are kept

- Provide online access and system-to-system interfaces to Mortgage Files as required by Freddie Mac
- Maintain an electronic audit trail for all electronic transactions occurred to the Mortgage Files, and keep such audit trail as part of the Mortgage Files for the life of the loan plus seven years
- Perform regular backups of all Mortgage File records, and be able to replace Electronic Records that are damaged, corrupted, or lost. All files must be archived for the life of the loan plus seven years.
- Maintain a geographically remote Disaster Recovery/Business Continuity Plan (DR/BCP) site that is not susceptible to the same disasters as the primary site for all Electronic Records. DR/BCP sites must follow the guidance set forth in Section 3.1.2.2.3.
- Document DR/BCP to provide recovery services of functionality, availability, and data to the point of failure within 48 hours of a declared disaster.

5.5.6 Damage or Loss

Servicers must bear the entire cost of restoring electronic Mortgage Files and related documents and records damaged or lost for any reason.

5.5.7 Ownership of Mortgage File and Related Records

All documents in the Mortgage File and all other documents and records of whatever kind or description, whether prepared or originated, held, or maintained by the Seller or others, including all current and historical computerized data files, which are reasonably required to originate and service Mortgages for Freddie Mac will be, and will remain at all times, the property of Freddie Mac. All records whether in paper or electronic format, in the possession of the Servicers are retained by the Servicers in a custodial capacity only.

5.5.8 Inspection of Mortgage Files by Freddie Mac

Both during and after termination of Servicing, the Servicer must permit Freddie Mac at any time during normal business hours to inspect the electronic Mortgage Files and all of the Servicers' records pertaining to mortgage operations related to Freddie Mac.

5.5.9 Transfer of File Custody and Security of File Information

Freddie Mac may at any time require the Servicer to deliver the following electronic documents to Freddie Mac, an eCustodian approved by Freddie Mac, or a transferee designated by Freddie Mac:

- A copy of any eNote, Security Instrument, assignment, and modifying instrument in the Servicer's custody, electronic or paper
- A copy of any Mortgage File, document within a Mortgage File, or other related documents and records in the Servicer's or their eCustodian's custody, electronic or paper, whether maintained as originals or copies.

Servicers may, without Freddie Mac's prior approval, entrust custody of all or part of the electronic Mortgage File to the eCustodian holding eNotes and assignments as indicated in the *Single-Family Seller/Servicer Guide.* When requested, Servicers must be able to identify to Freddie Mac those file items held by the eCustodian and document to Freddie Mac the eCustodian's acknowledgment that such file items:

- Are Freddie Mac's property

- Will be maintained by the eCustodian according to standards at least equal to those set forth in this section
- Will be maintained in such a way as to ensure the security and confidentiality of the information; protect against anticipated threats or hazards to the security or integrity of the information; and protect against unauthorized access to or use of such information
- Will be delivered to Freddie Mac upon request.

In addition, the Servicer agrees to indemnify Freddie Mac and hold Freddie Mac harmless for any loss, damage, or expense (including court costs and reasonable attorney fees) that Freddie Mac may incur as a result of the eCustodian's holding all or part of the electronic Mortgage File.

The Servicer must maintain an electronic copy of any original document that has been entrusted to the eCustodian for safekeeping. If all or part of the Mortgage File is held by the Servicer's eCustodian, the Servicer agrees to recover from the eCustodian (at the Servicer's expense) and provide to Freddie Mac (at the place and within the timeframe specified by Freddie Mac) any eCustodian-held original document requested by Freddie Mac for the post-funding quality control processes described in the *Single-Family Seller/Servicer Guide.*

Section 6 Delivery

This section addresses Freddie Mac's requirements for certifying, holding, and registering eNotes.

6.1 eCustodian Role and Responsibilities

The role of the eCustodian is to manage the receipt, tracking, and long-term safekeeping of the documents by:

- Verifying receipt of all custodial documents
- Holding documents in trust for Freddie Mac
- Certifying the eNote.

6.1.1 Required Custodial Documents

For Freddie Mac Selling System transactions, the Seller/Servicer must deliver the custodial documents indicated in the table below to the eCustodian before the Final Delivery Date of the eNote. Documents such as the signature affidavit, assignments, and lost note affidavit that are not listed below, but are required for paper loan transactions, are not likely to be applicable due to the nature of electronic documents and capabilities of MERS.

Document	Format
eNote, including any addenda	MISMO Category 1 SMART Document eNote
Modifying instrument such as a modification, conversion agreement, or assumption of indebtedness	MISMO Category 1 SMART Document eNote
Power of Attorney (POA)	The POA is available as a supporting document when there is a question regarding whether the signatory has legal authority to sign as attorney-in-fact for the person granting authority. If the POA is electronic, it must comply with state and local laws and can be stored in the eMortgage Vault or document management system. If the Power of Attorney is paper, it is maintained in the paper file. In all cases, the POA must be recorded with the Security Instrument. A copy of the recorded POA must be held by the eCustodian and a copy must be held in the Servicer's Mortgage File.

6.1.1.1 Holding the eNote, eNote Modifications, and Supplemental Documents

The Authoritative Copy of the eNote and any eMortgage Modifications to the Note and/or Security Instrument must be stored and remain at all times in an eMortgage Vault that complies with the specifications stated in Section 3.1.2.2 of this Handbook.

Electronic documents other than the Authoritative Copy of the eNote and any eMortgage Modifications to the eNote and/or Security Instrument may also be stored in the eMortgage Vault or in the Seller/Servicer's document management system.

The Seller/Servicer must provide the eCustodian with all custodial documents. These documents may be a combination of paper and electronic documents (e.g., paper POA and eNote) that result in multiple storage locations. The eCustodian is responsible for maintaining a reference list that identifies the location of electronic documents in the eMortgage Vault and paper documents in a traditional paper storage Vault. The standard identifier in the electronic Note Tracking System is a cross-reference of the MIN, Freddie Mac loan number, and internal reference such as the Seller/Servicer loan number.

When the custodial documents are a combination of paper and electronic documents (e.g., paper POA and eNote) that result in multiple storage locations, the eCustodian must maintain a list that identifies the location of electronic documents in the eMortgage Vault and paper documents in the Vault. The Freddie Mac loan number is the standard identifier for documents in the eMortgage Vault and paper vault.

6.1.2 Certifying the eNote

The eCustodian is required to certify the eNote before the contract Final Delivery Date. The eCustodian must verify the criteria indicated below before updating the certification event in the Freddie Mac Selling System and indicating that the certification process is complete.

Required Criteria	eCustodian Verifies:
eNote in Selling System	Selling System reflects the Note is electronic Selling System reflects the correct MIN for eNote.
eNote data to MERS® eRegistry	In the MERS® eRegistry, the tamper-evident digital signature matches eCustodian's eNote. *If verification cannot be completed, eCustodian must contact the Seller and resolve discrepancies before certification can occur.* *An addendum to an eNote such as the Balloon Note Addendum is part of the eNote and does not require separate certification.*
FHLMC loan number	Freddie Mac loan number on the Custodian tracking system matches data in the Freddie Mac Selling System.
eMortgage Modification MISMO Category 1 SMART Document	The Modification tamper-evident digital signature on the MERS® eRegistry. *eCustodian must contact the Seller or Servicer to resolve discrepancies before certification can occur.* *Note: Assumption Agreements and riders to Security Instruments are included in the category of eMortgage Modification.*
MISMO SMART Document Data and View equivalent	The Borrower has signed a MISMO Category 1 SMART Document in which the data in the View section corresponds to the data in Data section of the document. *eCustodian must contact the Seller or Servicer to resolve discrepancies before certification can occur.*

6.2 Using the MERS® eRegistry

The Seller/Servicer will be responsible for the accurate and timely preparation and recordation of Security Instruments and other documents relating to MERS-registered eMortgages and must take all reasonable steps to ensure that information on MERS is kept up-to-date and accurate at all times. The Seller/Servicer will also be solely responsible for any failure to comply with the provisions of the MERS Member Agreement, Rules, and procedures and for any liability that it or Freddie Mac incurs as a result of the registration of Mortgages with MERS or any specific MERS transaction. A transfer of control identifying Freddie Mac as the Controller of the eMortgage within the MERS® eRegistry does not relieve the

Mortgage Seller/Servicer from its responsibility for complying with all applicable provisions of the Freddie Mac Mortgage Purchase Documents, unless Freddie Mac specifies otherwise in writing.

6.2.1 Initial Registration of the Electronic Note in the MERS® eRegistry

The originating lender must perform the initial registration of an eNote with the MERS® eRegistry as soon as possible within 24 hours of closing for the loan to be purchased by Freddie Mac. Registration must occur before eNote certification and purchase by Freddie Mac. MERS serves as a Note holder registry that identifies the current Controller, Location of the Authoritative Copy of the eNote, and the Delegatee, if any, who is authorized by the Controller to make discrete updates to the record on behalf of the Controller.

The registered eNote shall be a MISMO Category 1 SMART Document, stored in an eMortgage Vault that meets Freddie Mac specifications described in Section 3 of this Handbook, and securely stored by an eCustodian that meets the criteria specified in Section 3 of this Handbook.

6.2.2 Executing a Transfer to Freddie Mac in the MERS® eRegistry

Before Freddie Mac will accept a transfer request, the following conditions must be met:

- All purchase edits are cleared for the loan in the Selling System
- A copy of the eNote has been sent to Freddie Mac
- The eCustodian has certified a copy of the Authoritative Copy.

Additionally, Freddie Mac requires that all eNote tamper-evident seals be validated against the MERS® eRegistry during eNote transfers. If a problem is discovered during the validation process, the Seller/Servicer is responsible for resolving the problem promptly.

Once the above conditions have been met, Freddie Mac's Selling System will accept and acknowledge the transfer request. Once Freddie Mac accepts the transfer request from the Seller/Servicer and becomes owner of a MERS-registered eNote, the MERS® eRegistry is updated to reflect the change of status identifying Freddie Mac as the Controller. MERS notifies Freddie Mac and the Seller/Servicer to confirm the change of control.

6.2.3 Recording Subsequent Actions in the MERS® eRegistry

The Seller/Servicer is responsible for recording the following subsequent actions in the MERS® eRegistry:

- Payoff
- Transfer of Location
- Foreclosure
- Modification

The Controller or its Delegatee must initiate a Change Status Request to the MERS® eRegistry to indicate that the record status has changed from active to inactive, such as after a payoff or charge off (refer to MERS® eRegistry documentation for additional guidance).

If a Servicer's MERS membership is terminated and the Servicer can no longer perform this function, Freddie Mac will transfer servicing to a MERS member.

6.2.4 Loan Rate and Term Modifications

Servicers must contact Freddie Mac's Loss Mitigation department before offering a Borrower a loan Modification.

6.2.4.1 eNote and eMortgage Modifications

All eNote modifications must be executed in accordance with Freddie Mac requirements and use language required by Freddie Mac. Contact Freddie Mac directly for details of this language.

The process to correct or change the data on the Authoritative Copy of the eNote is dependent on whether the eNote has been registered in the MERS® eRegistry.

For correcting or changing data on an eNote that has been registered, the Seller/Servicer follows the MERS® eRegistry Modification process. The data change must be captured in a MISMO-approved eMortgage Modification document (refer to Section 5.2 for document format guidance). Until a MISMO form is published, contact Freddie Mac for instructions.

Freddie Mac requires an electronic modification of an eNote and will not accept a paper Modification for an eNote unless:

- The modification agreement is recorded at the county recorder's office according to *Single-Family Seller/Servicer Guide* requirements
- The county in which the property securing the Mortgage is located is not able to record an electronic modification agreement.

In cases where the Borrower selects a paper Modification as allowed by law or the Servicer cannot support an electronic Modification, the Seller should contact Freddie Mac.

6.2.4.1.1 Conditions for Executing a Separate Modification of the Security Instrument

Modifications to a Freddie-Mac owned eNote should, if possible, be executed electronically. However, certain modification agreements make reference to the Security Instrument and must be recorded in the county land records (refer to the *Single-Family Seller/Servicer Guide* for additional information). When the Note and the Security Instrument both must be modified, and the particular county is unable to record an electronic modification agreement, the eNote must be modified using an electronic modification agreement, and the paper Security Instrument must be modified using a paper modification agreement.

Figure 1 illustrates the process that occurs following an electronic loan modification.

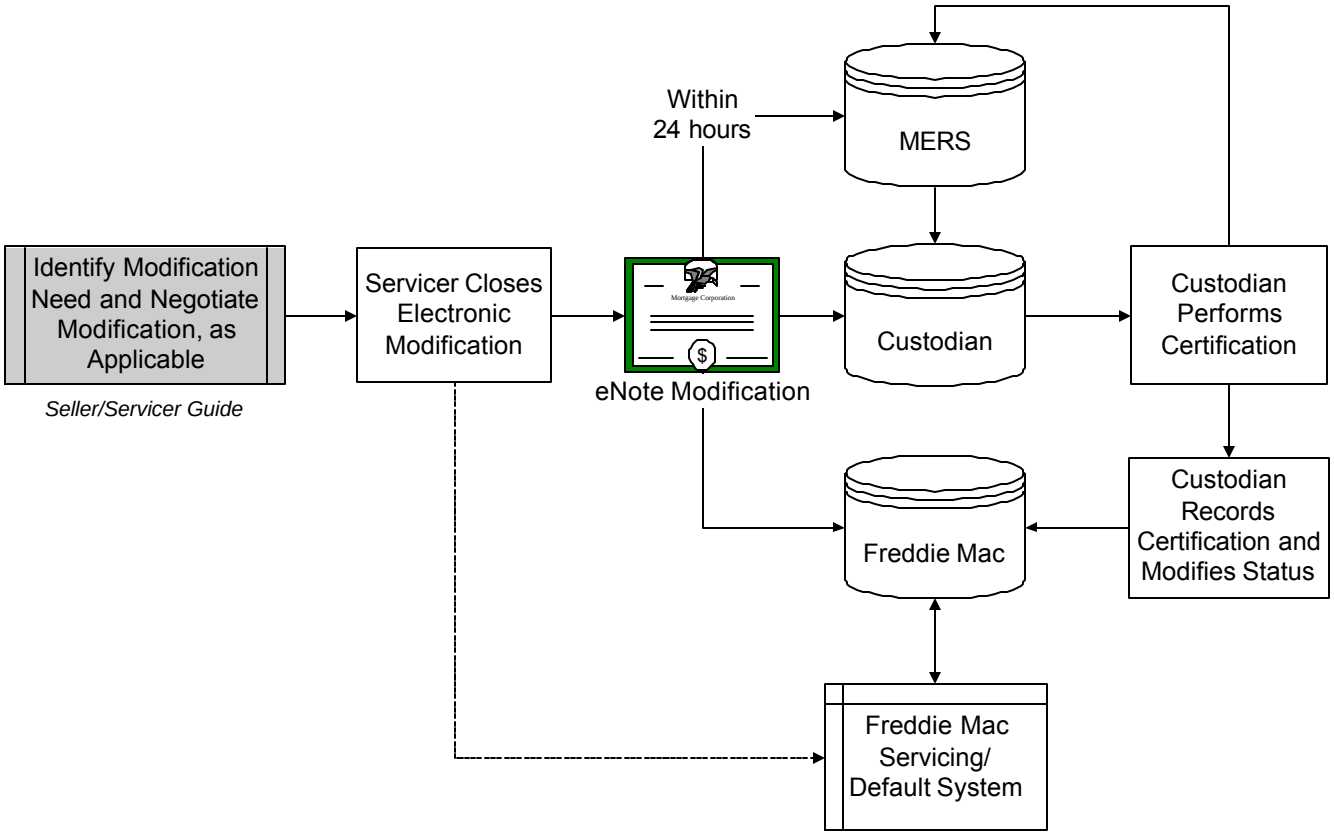

Figure 1: Electronic Loan Modification Process

6.2.4.1.2 Correcting Data on an eNote Not Registered in the MERS® eRegistry

Seller/Servicers and eCustodians must follow these steps to correct data on an eNote that has not yet been registered on the MERS® eRegistry.

Role	Responsibility
Seller/Servicer	1) Create a corrected eNote SMART Document that the Borrower will sign electronically 2) Register the corrected eNote on the MERS® eRegistry within 24 hours of the closing date 3) Notify and provide the eCustodian with the eNote within 24 hours of the registration date
Custodian	4) Certify the eNote and update the Freddie Mac Selling System by the Final Delivery Date (see Section 6.1.2 for certification guidance) 5) Update the Note Tracking System within three business days of the Final Delivery Date.

6.2.4.2 Registering and Certifying an eMortgage Modification

Seller/Servicers and eCustodians must follow these steps to register and certify an eMortgage Modification after the eNote has been registered in the MERS® eRegistry and certified by the Custodian.

Role	Responsibility
Seller/Servicer	1) Close an eNote Modification agreement in a MISMO Category 1 SMART Document. Contact Freddie Mac if a Modification is needed before MISMO has released an approved Category 1 SMART Document Modification. 2) Follow the Modification process that requires registration of the eMortgage Modification with the MERS® eRegistry within 24 hours of the closing date 3) Provide the eMortgage Modification to the eCustodian and Freddie Mac within 24 hours of the registration date
Custodian	4) Certify the eMortgage Modification and update the Freddie Mac Selling System within one business day after the registration date 5) Update their eNote Tracking System within three business days of the registration date.

6.2.4.3 Certifying eNotes and eMortgages Registered Before Sale to Freddie Mac

Sellers/Servicers and Custodians must follow these steps to certify eNotes and eMortgages that were registered on the MERS® eRegistry before the sale to Freddie Mac (i.e., seasoned loans).

Role	Responsibility
Seller/Servicer	1) Notify and provide the eCustodian with the eNote and eMortgage Modification by the Final Delivery Date
Custodian	2) Certify the eNote and eMortgage Modification and update the Freddie Mac Selling System by the Final Delivery Date (see Section 6.1.2 for certification guidance) 3) Update their Note Tracking System within three business days of the Final Delivery Date.

Section 7 Servicing Requirements

This section provides guidance on Freddie Mac's requirements for Transfers of Servicing, access to Custodial documents, and loss mitigation activities as they relate to eMortgages.

7.1 Transfers of Servicing

Transfer of Servicing of loans with eNotes or electronic Security Instruments, whether voluntary or involuntary, must be to a Servicer specifically and expressly approved by Freddie Mac to service eMortgages. Before executing any Transfer of Servicing, the Transferor Servicer must notify:

- The Transferee Servicer of any eMortgages contained in the Servicing portfolio that have any special servicing requirements unique to the eMortgages
- The eCustodian repository holding the eNotes
- MERS of any eMortgages where MERS is named as the nominee for the Seller/Servicer or named as assignee in the land records.

The Transferor Servicer and Transferee Servicer must take any and all actions necessary to transfer the eMortgage in accordance with Freddie Mac's requirements, which include but are not limited to, compliance with all laws, any system rules, registry, and repository requirements. If Freddie Mac approves the Transfer of Servicing, Freddie Mac will change the Delegatee on the MERS® eRegistry to the Transferee Servicer to allow the Transferee Servicer to record appropriate actions.

The eCustodian duties and obligations for eNotes can only be transferred to a new eCustodian that is specifically and expressly approved by Freddie Mac to hold eNotes. The Transferee eCustodian must have the expertise and systems and software to store and maintain the eNote.

7.1.1 Transfer Types and Associated Responsibilities

The following requirements apply to the transfer of electronic Documents and documents in hybrid files. Refer to the *Single-Family Seller/Servicer Guide* for definitions of the transfer types and a complete description of requirements for executing transfers.

Transfer Type	Role	File Type	Responsibilities
Concurrent	Transferor eCustodian	Electronic, Hybrid	▪ Transfer all eNotes and electronic custodial documents (vault-to-vault) to the Transferee eCustodian before Funding Date ▪ Maintain an authenticated copy of all eNotes and eMortgage Modifications for 180 days after Funding Date ▪ Work with the Transferee eCustodian to cure all unresolved document deficiencies before recertification of the eNotes by the Transferee eCustodian
	Transferee Custodian	Electronic, Hybrid	▪ Certify the eNote (see Section 6.1.2 for certification guidance) and any electronic Modification to the note or Security Instrument ▪ Update the Freddie Mac Selling System to indicate that certification occurred by the Final Delivery Date

Transfer Type	Role	File Type	Responsibilities
	Transferee Custodian	Hybrid only	▪ Perform verifications specified in the *Single-Family Seller/Servicer Guide* for each paper Note and assignment by the Final Delivery Date ▪ Update the Freddie Mac Selling System to indicate that recertification is complete no later than 15 days after the Effective Date of Transfer ▪ Update MERS with Delegatee and Transferee eCustodian as soon as the transfer is known.
	Freddie Mac	Electronic, Hybrid	▪ If Transferee eCustodian is not known, update the MERS® eRegistry with a Transfer of Location no later than three days after the Final Delivery Date.
Subsequent, Transfer of Custody (Seller/Servicer, eCustodian, or Freddie Mac initiates the termination of the Custodial Agreement)	Transferor eCustodian	Electronic, Hybrid	▪ Transfer all eNotes and electronic custodial documents (vault-to-vault) to the Transferee eCustodian no later than 30 days after the Effective Date of Transfer of Servicing ▪ Maintain an Authenticated Copy of all eNotes and eMortgage Modifications for 180 days after the Effective Date of Transfer of Servicing ▪ Work with the Transferee eCustodian to cure all unresolved document deficiencies before recertification of the eNotes by the Transferee eCustodian.
	Transferee eCustodian	Electronic, Hybrid	▪ Recertify the eNote (see Section 6.1.2 for certification guidance) and any electronic Modification to the Note or Security Instrument no later than 15 days after the Effective Date of Transfer of Servicing ▪ Update the Freddie Mac Selling System to indicate that recertification is complete no later than 15 days after the Effective Date of Transfer of Servicing.
	Transferee eCustodian	Hybrid only	▪ Perform verifications specified in the *Single-Family Seller/Servicer Guide* for each paper Note and assignment no later than 180 days after the Effective Date of Transfer of Servicing ▪ Update the Freddie Mac Selling System to indicate that recertification is complete no later than 15 days after the Effective Date of Transfer.
	Freddie Mac	Electronic, Hybrid	▪ Update the MERS® eRegistry with a Transfer of Location no later than three days after the recertification is reported in the Freddie Mac Selling System.

7.1.2 Obtaining Access to Custodial Documents

The Seller/Servicer or other parties (i.e., Freddie Mac) will, from time to time, need a copy of the eNote or other electronic Mortgage File documents to obtain view and print access to the eNote or other electronic Mortgage File documents held by an eCustodian to take appropriate action with:

- Payoff, foreclosure, repurchase, substitution, conversion, modification, or assumption of a Mortgage
- Request for view and print access by a Borrower as specified below
- Recordation of the assignment of a Security Instrument to Freddie Mac.

Seller/Servicer or other trusted parties must properly complete and send the Custodian Request for Release of Documents (Form 1036) to obtain a document held by the eCustodian.

Upon request, the eCustodian must provide an Authenticated Copy of one or more eNote and eMortgage Modification SMART Documents that could range in quantity from an individual request to all documents held in trust for an Investor.

The Servicer must provide the Borrower with view access to the Authoritative Copy of the eNote, or to print or download a copy of the Authoritative Copy of the eNote, from time to time, if requested by the Borrower. This is not intended to provide any Borrower with continuous or ongoing access to the Authoritative Copy of the eNote, but to permit the Borrower to: (i) view the Authoritative Copy of eNote the Borrower signed, or (ii) print or download a copy of the Authoritative Copy of the eNote the Borrower signed.

Freddie Mac is exploring requirements to satisfy the county land records that require an "original" eNote upon payoff or discharge.

7.1.3 Retention Period

The retention period for electronic documents is the same as that set forth for paper documents in the *Single-Family Seller/Servicer Guide.*

7.1.4 Sale of Mortgaged Premises Assumption of Mortgage

If the ownership of the Mortgaged Premises has been transferred and the property purchaser has assumed the eMortgage, any assumption agreement must be an Electronic Record signed by the new owner using an Electronic Signature and will be treated as an electronic loan modification agreement. The MERS® eRegistry must be updated to reflect the changed Borrower and the assumption agreement must be delivered and held in the same eMortgage Vault as the eNote. For additional requirements regarding loan modifications, refer to Section 6.2.4.

7.1.5 Loss Mitigation

This section provides requirements for loss mitigation activities as they relate to eMortgages.

7.1.5.1 eNote Modification Requirements

At present, Freddie Mac will not accept electronic modifications to paper Notes.

Electronic modification agreements must be executed in compliance with E-SIGN and UETA and any other laws necessary to maintain a valid enforceable eNote as well as with all requirements of this Handbook, including requirements for consent and Electronic Signatures. The signature requirements and notarization requirements are not modified because the modification is electronic. If notarization is not required by law or Freddie Mac today, electronic notarization is not required for the modification. If notarization is required by law or Freddie Mac, then the Electronic Signature must be witnessed in the physical presence of the notary public, and, if applicable, in the physical presence of any other required witnesses.

Modifications to a Freddie-Mac owned eNote must be reviewed and pre-approved by Freddie Mac.

The Servicer must validate that the paper modification agreement is recorded, if required, and logically associated with the eNote.

An electronic modification agreement that modifies an eNote must be registered in the MERS® eRegistry as soon as possible but not later than 24 hours after execution. If an electronic Note is modified using a

paper modification agreement, the Modification flag in the MERS® eRegistry must be set to Yes. Refer to Section 6 for requirements on submitting the modification agreement to the eCustodian and registering it in the MERS® eRegistry.

7.1.5.2 Short Payoffs

The Servicer is responsible for determining and executing the appropriate satisfaction documents for short payoffs, based on the requirements of the state in which the Mortgaged Premises is located.

7.1.5.3 Deed-in-Lieu

The Servicer is responsible for determining and executing the appropriate satisfaction documents for deeds-in-lieu, based on the requirements of the state in which the Mortgaged Premises is located.

7.1.6 Foreclosure, Bankruptcy, or Other Legal Proceedings

At present, and until legal experience with eMortgages has increased, the Servicer must contact Freddie Mac before pursuing legal action with respect to an eMortgage. The Servicer must use one of Freddie Mac's designated counsels or trustees specifically approved by Freddie Mac to handle eMortgage legal matters. If a Freddie Mac designated counsel or trustee is not available for the state in which the Mortgaged Premises is located, the Servicer must retain its own attorney, but the Servicer's attorney will be required to work with an attorney designated by Freddie Mac.

The Servicer is responsible for determining and executing the appropriate satisfaction documents for foreclosures or bankruptcies, based on the requirements of the state in which the Mortgaged Premises is located.

The Servicer is required to execute a Change Status Request in MERS following a foreclosure (see Section 6.2.3 for guidance).

7.1.7 Payoffs

The Servicer is responsible for determining and executing the appropriate satisfaction documents for payoff of an eMortgage, based on the requirements of the state in which the Mortgaged Premises is located.

The Servicer is required to execute a Change Status Request in MERS following a payoff (see Section 6.2.3 for guidance).

Appendix A: Authorized Uniform Instruments and Required Changes to Uniform Instruments

A.1 Electronic Notes

Freddie Mac requires that the Seller/Servicer use a Uniform Note, as follows:

A.2 Note Heading

An Electronic Note must contain the following heading:

Note
(For Electronic Signature)

A.3 New Paragraph 11

An electronic Note must contain a new paragraph 11 as follows:

"11. ISSUANCE OF TRANSFERABLE RECORD; IDENTIFICATION OF NOTE HOLDER; CONVERSION FROM ELECTRONIC NOTE TO PAPER-BASED NOTE

(A) I expressly state that I have signed this electronically created Note (the "Electronic Note") using an Electronic Signature. By doing this, I am indicating that I agree to the terms of this Electronic Note. I also agree that this Electronic Note may be Authenticated, Stored and Transmitted by Electronic Means (as defined in Section 11(F)), and will be valid for all legal purposes, as set forth in the Uniform Electronic Transactions Act, as enacted in the jurisdiction where the Property is located ("UETA"), the Electronic Signatures in Global and National Commerce Act ("E-SIGN"), or both, as applicable. In addition, I agree that this Electronic Note will be an effective, enforceable and valid Transferable Record (as defined in Section 11(F)) and may be created, authenticated, stored, transmitted and transferred in a manner consistent with and permitted by the Transferable Records sections of UETA or E-SIGN.

(B) Except as indicated in Sections 11 (D) and (E) below, the identity of the Note Holder and any person to whom this Electronic Note is later transferred will be recorded in a registry maintained by **[Insert Name of Operator of Registry here]** or in another registry to which the records are later transferred (the "Note Holder Registry"). The Authoritative Copy of this Electronic Note will be the copy identified by the Note Holder after loan closing but prior to registration in the Note Holder Registry. If this Electronic Note has been registered in the Note Holder Registry, then the authoritative copy will be the copy identified by the Note Holder of record in the Note Holder Registry or the Loan Servicer (as defined in the Security Instrument) acting at the direction of the Note Holder, as the authoritative copy. The current identity of the Note Holder and the location of the authoritative copy, as reflected in the Note Holder Registry, will be available from the Note Holder or Loan Servicer, as applicable. The only copy of this Electronic Note that is the authoritative copy is the copy that is within the control of the person identified as the Note Holder in the Note Holder Registry (or that person's designee). No other copy of this Electronic Note may be the authoritative copy.

(C) If Section 11 (B) fails to identify a Note Holder Registry, the Note Holder (which includes any person to whom this Electronic Note is later transferred) will be established by, and identified in accordance with, the systems and processes of the electronic storage system on which this Electronic Note is stored.

(D) I expressly agree that the Note Holder and any person to whom this Electronic Note is later transferred shall have the right to convert this Electronic Note at any time into a paper-based Note (the "Paper-Based Note"). In the event this Electronic Note is converted into a Paper-Based Note, I further expressly agree that: (i) the Paper-Based Note will be an effective, enforceable and valid negotiable

instrument governed by the applicable provisions of the Uniform Commercial Code in effect in the jurisdiction where the Property is located; (ii) my signing of this Electronic Note will be deemed issuance and delivery of the Paper-Based Note; (iii) I intend that the printing of the representation of my Electronic Signature upon the Paper-Based Note from the system in which the Electronic Note is stored will be my original signature on the Paper-Based Note and will serve to indicate my present intention to authenticate the Paper-Based Note; (iv) the Paper-Based Note will be a valid original writing for all legal purposes; and (v) upon conversion to a Paper-Based Note, my obligations in the Electronic Note shall automatically transfer to and be contained in the Paper-Based Note, and I intend to be bound by such obligations.

(E) Any conversion of this Electronic Note to a Paper-Based Note will be made using processes and methods that ensure that: (i) the information and signatures on the face of the Paper-Based Note are a complete and accurate reproduction of those reflected on the face of this Electronic Note (whether originally handwritten or manifested in other symbolic form); (ii) the Note Holder of this Electronic Note at the time of such conversion has maintained control and possession of the Paper-Based Note; (iii) this Electronic Note can no longer be transferred to a new Note Holder; and (iv) the Note Holder Registry (as defined above), or any system or process identified in Section 11 (C) above, shows that this Electronic Note has been converted to a Paper-Based Note, and delivered to the then-current Note Holder.

(F) The following terms and phrases are defined as follows: (i) "Authenticated, Stored and Transmitted by Electronic Means" means that this Electronic Note will be identified as the Note that I signed, saved, and sent using electrical, digital, wireless, or similar technology; (ii) "Electronic Record" means a record created, generated, sent, communicated, received, or stored by electronic means; (iii) "Electronic Signature" means an electronic symbol or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign a record; (iv) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form; and (v) "Transferable Record" means an electronic record that: (a) would be a note under Article 3 of the Uniform Commercial Code if the electronic record were in writing and (b) I, as the issuer, have agreed is a Transferable Record."

A.4 Note Tagline

An Electronic Note must contain a new tagline. Freddie Mac will provide this information as and when needed.

Appendix B: Glossary of Terms

Alteration means a change to the terms or conditions of a Record, or change in the variable information added to the Record, after it is signed, or if it is not required to be signed, after it is delivered to the intended recipient.

Assumption means a transfer of the primary obligation to pay the mortgage indebtedness secured by a Mortgage lien on property from the seller of property to the purchaser of the property.

Authenticated Copy means the duplicate of the Authoritative Copy with the same tamper-evident digital signature.

Authoritative Copy means the copy of the Transferable Record (eNote) that has been registered on the MERS® eRegistry.

Borrower means a Borrower as defined in the *Single-Family Seller/Servicer Guide*, and in addition, any Person purchasing the real property securing the loan, executing the promissory note (eNote/Transferable Record), executing a guaranty of the debt evidenced by the promissory note (eNote/Transferable Record), or signing a security instrument in connection with a loan.

Consumer means a Person defined as a Consumer under, (i) the federal E-SIGN Act, to the extent E-SIGN applies to a transaction or (ii) applicable state law, to the extent state law applies to a transaction.

Control means that a Person has control of an eNote (Transferable Record) if a system employed for evidencing the transfer of interests in the eNote (Transferable Record) reliably establishes that Person is the Person to which the eNote (Transferable Record) was issued or transferred pursuant to Section 16 of UETA and Section 201 of E-SIGN. (For example, having Control of an eNote (Transferable Record) resulting from an electronic loan transaction can be thought of as comparable to having possession of an original paper note resulting from a paper loan transaction.)

Controller means the Person named in the MERS® eRegistry that has Control of the Authoritative Copy of the eNote (Transferable Record). (For example, the Controller can be thought of as the "holder," "holder in due course," and/or "purchaser" of an original paper note as defined under the Uniform Commercial Code.)

Delegatee means a member of the MERS® eRegistry that is authorized by the Controller to perform certain MERS® eRegistry transactions on the Controller's behalf.

Digital Signature or Encryption Key means an asymmetric encryption transformation used to approve or sign an Electronic Record or detect Alteration of an Electronic Record.

Document Custodian means the custodian as defined in the *Single-Family Seller/Servicer Guide*.

E-SIGN means the federal Electronic Signatures in Global and National Commerce Act passed by Congress and signed into law by the President in 2000 that governs certain types of electronic transactions in states and territories that have not enacted the federally approved version of UETA. E-SIGN pre-empts, in whole or in part, state and territory enactments of UETA that deviate from the federally approved version of UETA. For example, the E-SIGN governs the creation, registration, transfer, maintenance, and storage of electronic promissory notes in states and territories that have not enacted the federally approved version of UETA.

eCustodian means the Freddie Mac-approved electronic note custodian.

Electronic Note or eNote means an electronic record that would be a promissory note if it was issued in paper, and that the Borrower has agreed to issue as a Transferable Record.

eNote Modification means an amendment to an eNote. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means a transaction on the MERS® eRegistry reflecting a change to one or more provisions of a specified eNote.

Electronic Record means a Record created, generated, sent, communicated, received, or stored by electronic means.

Electronic Signature means an electronic symbol or process attached to or logically associated with a Record and signed or adopted by a Person with the intent to sign the Record.

Electronic Mortgage Vault or eMortgage Vault means a transferable records management solution that meets E-SIGN, UETA, and other compliance requirements. The concept is somewhat similar to that of the vaults that hold paper records and administered by the document custodian industry today. In addition to the Transferable Records, the solution may support other types of electronic Documents.

Foreclosure means the legal process initiated by a mortgagee following a default by the mortgagor in which the mortgagor's interest in the Mortgaged Premises is forfeited to pay the sums due and payable to the mortgagee under a promissory note secured by the Mortgage. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means that the Servicer, as Delegatee, initiates an update in the MERS® eRegistry.

Loan Modification means an amendment to a Note or Mortgage. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means that the Servicer, as Delegatee, initiates a modification flag update on the MERS® eRegistry and registers the modification agreement as a new eNote (Transferable Record) (old and new are cross-referenced on the MERS® eRegistry). If the new Note is still an eNote (Transferable Record), the Authoritative Copy of the Transferable Record is sent to an eMortgage Vault. If the new Note is paper, it is sent to the document custodian.

Location means the Person named on the MERS® eRegistry that maintains the Authoritative Copy of the eNote either as Controller or as a custodian on behalf of the Controller.

MERS means Mortgage Electronic Registration Systems, Inc.

MERS® eRegistry means the electronic registry operated by MERSCORP, Inc. that serves as the system of record to identify the current Controller and Location of the Authoritative Copy of an eNote.

MERS® System means an electronic registry that tracks changes in loan servicing and beneficial ownership rights. Member companies update the registry via MERS® OnLine (the browser-based interface) or through batch file interfaces.

MIN or Mortgage Identification Number means the 18-digit number composed of a seven-digit Organization ID, 10-digit sequence number, and check digit. The MIN is used to cross-reference eNotes to modifications and addenda.

MISMO or Mortgage Industry Standards Maintenance Organization means the body created by the Mortgage Bankers Association (MBA) in October 1999 to develop, promote, and maintain voluntary electronic commerce standards for the mortgage industry.

MOM means MERS as the Original Mortgagee. This language is written into security instruments to establish MERS as the Original Mortgagee and nominee for the Lender, its successors, and assigns.

Mortgage File means the following documents: promissory note (eNote/Transferable Record), security instrument, consumer disclosures, title insurance policy or other evidence of title, hazard insurance binder or certificate, flood zone certificate, collateral assessment information, and other documents associated with a real estate secured loan required in accordance with the *Single-Family Seller/Servicer Guide* and/or customarily included in the loan documentation file created by the originating lender (see the *Single-Family Seller/Servicer Guide*).

Note holder means the Person to whom the eNote (Transferable Record) was issued as original obligee or, if the eNote (Transferable Record) has been transferred, the current transferee entitled to enforce the note.

Original Borrower means that this field on the MERS® eRegistry, in the case of an Assumption, reflects the Person or Persons who were originally named as the Borrowers in the associated eNote.

Paid Off means a mortgage has been paid in full. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means a Change Status Request transaction on the MERS® eRegistry reflecting a payoff of a specified eNote.

Payoff means the amount of money that must be paid to satisfy an outstanding indebtedness. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means that the Seller/Servicer/Servicer, as Delegatee of Freddie Mac, initiates an update on the MERS® eRegistry. Servicer provides a "certified" copy of the eNote marked "Paid Off" or "Canceled" to the Borrower. The eMortgage Vault is updated with payoff information; eNote is "archived." MERS receives and records payoff update on eRegistry.

Person means a natural Person or a legal entity.

PIN means a Personal identification number.

Procedure or Process means the series of actions or steps necessary to perform a particular task or meet a particular requirement of these specifications. Except where applicable law or the context requires otherwise, a Procedure may be deployed through electronic means, or involve steps or actions which are non-electronic, or a combination of the two.

Property Owner means any Person who owns an interest in the real property securing the mortgage, either before or after the loan is originated, other than a Person whose only interest in the real property is as a lien holder.

Record means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Registration Reversal means a transaction that reverses the registration of an eNote from the MERS® eRegistry that was registered in error.

Repurchase means a Seller is required to reacquire a Mortgage sold to Freddie Mac by paying a specified price to Freddie Mac and accepting transfer of ownership of the Mortgage from Freddie Mac. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means that the Investor transfers the Authoritative Copy of the eNote (Transferable Record) to the Seller/Servicer's eMortgage Vault. The Seller/Servicer's eMortgage Vault confirms and stores the Authoritative Copy of the eNote (Transferable Record). MERS receives and records the transfer of control and location of the Authoritative Copy of the eNote (Transferable Record) in the MERS® eRegistry. Freddie Mac returns control of the eNote (Transferable Record) to the Servicer because Freddie is no longer the owner of the eNote (Transferable Record).

Seller/Servicer means the Seller/Servicer as defined in the *Single-Family Seller/Servicer Guide*.

Servicer means the Seller/Servicer or Servicer as defined in the *Single-Family Seller/Servicer Guide*.

SISAC means Secure Identity Services Accreditation Corporation. SISAC is responsible for accrediting digital identity credential issuers for the mortgage industry. SISAC is owned by the MBA.

SMART Document or SMART Doc means an electronic document created to conform to a specification standardized by MISMO. A SMART Document locks together data and presentation in such a way that it can be system-validated to guarantee the integrity of the document. There are different categories of SMART Docs as specified by MISMO that may be referenced in this Handbook.

System means a computer system, or any component of such computer system, used to create, register, transfer, store, maintain, retrieve, and/or secure an eNote or other electronic Mortgage File documents.

System Provider means a Person that provides a System, or any component of such System, used to create, register, transfer, store, maintain, retrieve, and/or secure an eNote or other electronic Mortgage File documents.

System Rules mean the rules embedded in a System by the System Provider that must be agreed to by all parties using a particular System.

Tamper-Evident Digital Signature means a "seal" wrapping an electronic document that is created by a digital signature. The seal can be verified to ensure that no changes have been made to the document since the seal was put in place. Sometimes referred to as "evident digital signature," "tamper-evident seal," "tamper seal" or "hash value."

Tamper Seal means to use an Encryption Key to authenticate the combination of an Electronic Record and existing Electronic Signatures associated with that Electronic Record, or to detect Alterations to the combination of the Electronic Record and the prior Electronic Signatures, or to authenticate or detect Alterations in a package of multiple Electronic Records. A tamper "seal" wraps an electronic document that is created by a digital signature. The seal can be verified to ensure that no changes have been made to the document since the seal was put in place. Also known as "tamper-evident digital signature."

Transfer of Control means the relinquishment of a person's right, title, and interest in an eNote (Transferable Record) to another person within an electronic registry. If MERSCORP, Inc. is the designated Note Holder Registry in the eNote, it also means a MERS® eRegistry transaction that results in a change in the Controller of the eNote (Transferable Record).

Transfer of Servicing means the assignment, sale, conveyance or other transfer of all Servicing duties and responsibilities set forth in the Purchase Documents with respect to Mortgages and Real Estate Owned (REO) owned in whole or in part by Freddie Mac.

Transferable Record means an Electronic Record under E-SIGN and UETA that (1) would be a note under the Uniform Commercial Code if the Electronic Record were in writing; (2) the issuer of the Electronic Record expressly has agreed is a Transferable Record; and (3) for purposes of E-SIGN, relates to a loan secured by real property. A Transferable Record is also referred to as an eNote.

Trusted Third Party means a Person other than the Note holder or Seller/Servicer who is in the business of providing services intended to enhance (i) the trustworthiness of the Process for signing Electronic Records using an Electronic Signature, or (ii) the integrity and reliability of the signed Electronic Records.

UCC means the Uniform Commercial Code, which is a model code promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and then recommended by NCCUSL to the states and territories of the United States for adoption and which, if enacted into law in a particular state or territory, governs certain types of commercial transactions and instruments within its purview. For example, UCC Article 3 governs paper negotiable instruments, including promissory notes secured by mortgages.

UETA means the Uniform Electronic Transactions Act of 1999, which is a model act promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and then recommended by NCCUSL to the states and territories of the United States for adoption, and, which if enacted into law in a particular state or territory, governs certain types of electronic transactions within its purview, unless pre-empted in whole or in part by E-SIGN. For example, UETA governs eNotes (Transferable Records) secured by Mortgages.

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