Who Owns the Note?: A Securitization Primer

Tara Twomey, Of Counsel, National Consumer Law Center

Lauren Mahoney
National Consumer Law Center

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Presenter – Tara Twomey

• Tara Twomey is currently Of Counsel to the National Consumer Law Center and the Project Director for the National Consumer Bankruptcy Rights Center.
• She has previously lectured at Stanford, Harvard and Boston College Law Schools.
• She is a contributing author of several books published by the National Consumer Law Center, including Foreclosures and Bankruptcy Basics.
My understanding of RMBS Securitization is:

a. Beginner (none or little)

b. Intermediate (I get the basics)

c. Advanced (I know enough to be trouble)

d. Expert!
True or False

In Arizona a deed of trust may only be enforced by, or on behalf of, a person who is entitled to enforce the obligation that the deed of trust secures.

a. True
b. False
Who Cares?
Originator

Borrower

$$$  Note & Mortgage
RMBS Securitization Map

Master Servicer
Prepares reports for Trustee; remits monies; ensures Primary performs

Primary Servicer
Services individual loans, collects payments, performs duties under PSA

Interim Servicer
Services loans until securitized

Originator
Processes and funds individual loans

Seller
Purchases loans from originator; forms pool

Depositor
Creates issuing entity

Underwriter
Sells certificates to investors, collects proceeds

Trust
Holds pool of loans; issues certificates

Trustee
Oversees servicers

Buyer
Received broker’s fee, YSP and processing fees

Various Classes
Investors/Certificate Holders
Purchase mortgage-backed securities as defined in certificates

MLPA

PSA

Note & Mortgage

Pool revenue less servicing fee

$ Purchase price

$ Purchase price

$ Fees

$ Purchase price

$ Purchase price

$ Purchase price

Other parties not shown may include Credit Risk Manager, Securities Administrator, Swap Counterparty, and Rating Agencies.
In re Vasquez,
228 Ariz. 357, 266 P.3d 1053 (2011)

Hogan v. Wash. Mut. Bank, N.A.,
230 Ariz 584, 277 P.3d 781 (2012)

Steinberger v. McVey ex rel. Co. of Maricopa, et al.
234 Ariz. 125, 318 P.3d 419
Moving Mortgage Loans
Other parties not shown may include Credit Risk Manager, Securities Administrator, Swap Counterparty, and Rating Agencies.
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Pool revenue less servicing fee

$33 offering proceeds

$33 purchase price

MLPA or PSA

PSA

Note & Beneficiary DOT

$33 fees

$33 less Trustee’s fee

$33 less servicing fee

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**Pool revenue less servicing fee**

**Certificates**

$\text{MLPA}$
or $\text{PSA}$

**Certificates$$ offering proceeds

**Certificates$$ purchase price

**MLPA$$ purchase price

**MLPA$$ offering proceeds

**Note & Beneficiary DOT**

**Note & Beneficiary DOT**

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Note & Beneficiary DOT

**Trust**
$$ less Trustee’s fee

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**RMBS Securitization Map**

**AIR**
- **Originator**
  - Processes and funds individual loans
  - **Note**
  - **Borrower**
    - Received broker’s fee, YSP and processing fees
    - **Note**
  - **Interim Servicer**
    - Services loans until securitized
    - **Note**
  - **Primary Servicer**
    - Services individual loans, collects payments, performs duties under PSA
    - **Note**
  - **Master Servicer**
    - Prepares reports for Trustee; remits money; ensures Primary performs
    - **Note**

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  - **Note**
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    - Creates issuing entity
    - **Note**
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    - **Note**
  - **Buyer**
    - **Note**
  - **Trust**
    - Holds pool of loans; issues certificates
    - **Note**

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- **Trustee**
  - Oversees servicers
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**Originator**
Processes and funds individual loans

**Borrower**
Mortgage Payments

**Mortgage Broker**
Received broker’s fee, YSP and processing fees

**Interim Servicer**
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**Note & Beneficiary DOT**

**Certificates**

**Certificates**

**MLPA or PSA**

**PSA**

**MLPA or PSA**

**PSA**

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**PSA**

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**Various Classes**
Investors/Certificate Holders
Purchase mortgage-backed securities as defined in certificates

**Trustee**'s fee

**Pool revenue less servicing fee**

**MLPA or PSA**

Other parties not shown may include Credit Risk Manager, Securities Administrator, Swap Counterparty, and Rating Agencies.
Is the Note a negotiable instrument?

Entity may enforce the Note

Is the Note indorsed to the entity seeking to enforce?

Yes

Entity may enforce the Note

Is there a written sale agreement?

Yes

Entity may enforce the Note

No

Entity may NOT enforce the Note

Was value given?

Yes

Entity may enforce the Note

No

Entity may NOT enforce the Note

Did the seller have the right to sell the Note?

Yes

Entity may enforce the Note

No

Entity may NOT enforce the Note

Are all other requirements of the contract satisfied?

Yes

Entity may enforce the Note

No

Entity may NOT enforce the Note

Is the entity in possession of the collateral?

Yes

Entity may enforce the Note

No

Entity may NOT enforce the Note

Is the agreement authenticated and does it have a description of the collateral?

Yes

Entity may enforce the Note

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Is there a written sale agreement?

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Entity may enforce the Note

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Entity may enforce the Note
Is the Note a negotiable instrument?
What is a negotiable instrument?

- Defined in UCC § 3-104
- Unconditional promise to pay a fixed amount of money, with or without interest
- Must be payable to bearer or order
- Payable on demand or at a definite time
- Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money.
Is the Note a negotiable instrument?

No, go to Article 9
The Sale of Promissory Notes Under Article 9
Article 9 – Secured Transactions

- **Scope** § 9-109(a)(3)
  - Covers the sale of accounts, chattel paper, payment intangibles and promissory notes as well as traditional security interests.

- A debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold. § 9-318.

- The “debtor” in Article 9 language includes the seller of promissory notes. § 9-102(a)(28).
Article 9 – Secured Transactions

- § 9-203(b): A security interest is enforceable against the debtor when:
Article 9 – Secured Transactions

- § 9-203(b): A security interest. The sale of notes is enforceable against the debtor seller when:
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**Investors/Certificate Holders**
Purchase mortgage-backed securities as defined in certificates

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Holds pool of loans; issues certificates

**Trustee**
Oversees servicers

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**Certificates**

**Note & Mortgage**

**Depositor**
Note & Mortgage

**MLPA**

**PSA**

**$$_{}$$ offering proceeds

**MLPA or PSA**

**$$_{}$$ purchase price

**Primary Servicer**

**$$_{}$$ less servicing fee

**$$_{}$$ less Trustee’s fee

**$$_{}$$ fees

**Other parties not shown may include Credit Risk Manager, Securities Administrator, Swap Counterparty, and Rating Agencies**
Article 9 – Secured Transactions

- § 9-203(b): A security interest. The sale of notes is enforceable against the debtor seller when:
  - Value has been given
  - Seller has rights (or the power to transfer rights) in the collateral/notes
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** Trustee **
Oversees servicers

** Mortgage Broker **
Received broker’s fee, YSP and processing fees

** Borrower **

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Article 9 – Secured Transactions

- § 9-203(b): A security interest. The sale of notes is enforceable against the debtor seller when:
  - Value has been given
  - Seller has rights (or the power to transfer rights) in the collateral/notes
  - Either of the following conditions is met:
    - Seller has authenticated a security agreement that provides a description of the collateral,
Article 9 – Secured Transactions

- § 9-108: addresses the sufficiency of the “description” of the “collateral,” i.e., the promissory notes being sold.

- General standard (§ 9-108 (a)): description must “reasonably” identify the loan notes. Examples of reasonable identification include: 1) a specific listing; 2) by category; 3) by “type”; or 6) any other method if the identity of the collateral is “objectively determinable.” § 9-108(b).

- “Supergeneric” descriptions not sufficient, e.g., “all of the seller’s loans.” § 9-108(c).
Schedule I

MORTGAGE LOAN SCHEDULE
(by Loan Group)
Article 9 – Secured Transactions

- § 9-203(b): A security interest: The sale of notes is enforceable against the debtor seller when:
  - Value has been given
  - Seller has rights (or the power to transfer rights) in the collateral/notes
  - Either of the following conditions is met:
    - Seller has authenticated a security agreement that provides a description of the collateral, OR
    - Buyer has possession of the collateral
Is the Note a negotiable instrument?

Is the entity seeking to enforce the Note in possession of the Note?

Is the Note indorsed in blank?

Is the Note indorsed to the entity seeking to enforce?

Is there a written sale agreement?

Did the seller have the right to sell the Note?

Was value given?

Are any other requirements of the contract satisfied?

Is the agreement authenticated and does it have a description of the collateral?

ARTICLES 3 & 9 FLOW CHART
Art. 9: Mortgage Follows the Note

- § 9-203(g): The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

- § 9-203(a): Security interest/sale attaches when the security/sale agreement becomes enforceable

- § 9-203(b): Security/sales agreement becomes enforceable when value is given, debtor/seller has right to transfer collateral, and either authenticated agreement with description of collateral or possession.
§ 5.4 : Transfer of Mortgages and Obligations Secured by Mortgages

(a) A transfer of the obligation secured by the mortgage also transfers the mortgage, unless parties agree otherwise.

(b) Except as otherwise provided by the UCC, a transfer of the mortgage also transfers the obligation, unless the parties agree otherwise.

(c) A mortgage may be enforced only by, or on behalf of, a person who is entitled to enforce the obligation.
States may require that an assignment of the mortgage be recorded before one can enforce the mortgage. Examples of these states are California (but see Calvo, 130 Cal. Rptr. 3d 815 (Cal. Ct. App. 2011)) and Georgia.

If so, this requirement arguably trumps the “mortgage-automatically follows note” doctrine and vests the note holder (or the party with the right to enforce the note) with authority to foreclose only when the mortgage assignment is recorded.

Other restrictions in your state’s law?
Are all other requirements of the agreement satisfied?
Other requirements?

- Parties can contract around Article 9 provisions, with limited exception - Revised § 1-302 (but cannot contract around definitions in Articles 3 and 9—see below).

- Does the Pooling and Servicing Agreement or Mortgage Loan Purchase Agreement create additional requirements in order to transfer the note?
Other requirements?

- Transfer provisions in the PSA (usually ¶ 2.01) or the MLPA contain two parts:
  - 1. Seller “hereby” sells, assigns, etc. mortgage loans to trust/issuer, AND
  - 2. “in connection with” this sale there will be a specified action with respect to the notes and/or mortgages
Other requirements?

- For example, notes will be “endorsed either (A) in blank, in which case the Trustee shall cause the endorsement to be completed or (B) in the following form: “Pay to the order of [Trustee], as Trustee, without recourse…”

- “A complete unbroken chain of endorsements” from originator to the depositor, and then in blank (to be filled in) or special endorsement to the trust...

- “An original assignment. The Mortgagee shall be assigned either (A) in blank or (B) to [Trustee], as Trustee, without recourse…”

- “An original of any intervening assignment of Mortgage showing a complete chain of assignments…”
Is the Note a negotiable instrument?

Is the entity seeking to enforce the Note in possession of the Note?

Is the Note indorsed in blank?

Is there a written sale agreement?

Did the seller have the right to sell the Note?

Was value given?

Are any other requirements of the contract satisfied?

Is the agreement authenticated and does it have a description of the collateral?

Entity may enforce the Note

Entity may not enforce the Note

Entity may not enforce the Note

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Entity may enforce the Note
Is the Note a negotiable instrument?

Entity may enforce the Note

Is the entity in possession of the collateral?

Entity may NOT enforce the Note

Is the agreement authenticated and does it have a description of the collateral?

Entity may NOT enforce the Note

Did the seller have the right to sell the Note?

Entity may NOT enforce the Note

Was value given?

Entity may NOT enforce the Note

Is there a written sale agreement?

Entity may NOT enforce the Note

Is the Note indorsed to the entity seeking to enforce?

Entity may NOT enforce the Note

Is the Note indorsed in blank?

Entity may not enforce the Note

Is the entity in possession of the collateral?

Entity may enforce the Note

Are any other requirements of the contract satisfied?

Entity may enforce the Note

Entity may NOT enforce the Note

Did the seller have the right to sell the Note?

Entity may enforce the Note

Was value given?

Entity may enforce the Note

Is there a written sale agreement?

Entity may enforce the Note

Is the Note indorsed to the entity seeking to enforce?

Entity may enforce the Note

Is the entity in possession of the collateral?

Entity may enforce the Note

Is the note a negotiable instrument?
Is the Note a negotiable instrument?

Yes, go to Article 3
Negotiable Instruments
Is the Note a negotiable instrument?

- Entity may enforce the Note
- Entity may NOT enforce the Note

Is the entity in possession of the collateral?

- Entity may enforce the Note
- Entity may NOT enforce the Note

Is the Note indorsed in blank?

- Entity may enforce the Note
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- Entity may enforce the Note
- Entity may NOT enforce the Note

Yes

ARTICLES 3 & 9 FLOW CHART

No
Negotiation

- § 3-201(a): “Negotiation” means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

- § 3-201(b): Except for negotiation by remittur, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.
Non-“Negotiation” Transfers

- § 3-203(a): An instrument is transferred when it is delivered for the purpose of giving the transferee the right to enforce the instrument.

- § 3-203(b): Regardless of whether the transfer is a “negotiation,” a transfer vests in the transferee any right of the transferor to enforce the instrument.

- Comment 2: “Because the transferee’s rights are derivative of the transferor’s rights, those rights must be proved.”
Who is PETE?
**Person Entitled to Enforce**

- § 3-301: “Person entitled to enforce” an instrument means
  - (i) the holder of the instrument;
  - (ii) a nonholder in possession of the instrument who has the rights of a holder, or
  - (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.
Holder

- Revised § 1-201(a)(21): “Holder” means:
  (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession
Is the Note a negotiable instrument?
Is the entity in possession of the Note?
Is the note indorsed in blank?
Is the entity seeking to enforce the Note?
Is there a written sale agreement?
Was value given?
Did the seller have the right to sell the Note?
Are any other requirements of the contract satisfied?

Entity may enforce the Note
Entity may NOT enforce the Note
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ARTICLES 3 & 9 FLOW CHART
PAY TO THE ORDER OF
WITHOUT RECOURSE
FLAGSTAR BANK, FSB

BY: Jean R. Garlock, Senior Vice President

PAY TO THE ORDER OF
Flagstar Bank, FSB
WITHOUT RECOURSE

Florida Home Equity LLC
By: Paul Cooper Smith
Paul Cooper Smith
Loan Operations Associate
Indorsements and Allonges

- Indorsements are required to transfer loan notes that are payable to an identified person until the payee (lender) or a subsequently identified person indorses in blank or to bearer. § 3-201(b) (negotiation); § 3-109 (payable to bearer or order); § 3-205 (special indorsement; blank indorsement).

- Indorsements must appear on the note but can appear on a paper (allonge) “affixed to the instrument.” § 3-204(a). (Note: NY UCC § 3-202(2) still says “firmly affixed”).
Proof of the Rights of the Transferor

- When the transferee is not a “holder,” the transferor must have been a holder at the time of transfer. § 3-203, Comment 2.

- When the note is not payable to the transferee, the transferee must account for possession of the unindorsed note by proving the transaction through which the transferee acquired it. § 3-203, Comment 2.
Other Requirements

- Can the PSA vary the requirements of Article 3?
- A PSA cannot change the definitions included in the UCC. Revised § 1-302, Comment 1. This Comment specifically mentions the definitions of “negotiation,” “negotiable instrument,” and “holder-in-due-course.”
The Relationship Between Article 3 and Article 9
Relationship between Article 9 and Article 3

- § 3-102: If there is a conflict between this Article and Article 4 or 9, Articles 4 or 9 govern.

- § 9-331: This article does not limit the rights of a holder in due course of a negotiable instrument...These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8.

- A word about § 9-601, et seq.
More on the Relationship between Article 9 and Article 3

- § 9-308, Comment 6 - For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person whom the maker must pay to discharge the note and any lien securing it.

- § 9-607, Comment 8 ("Of course, the secured party’s rights derive from those of its debtor. Subsection (b) would not entitle the secured party to proceed with a foreclosure unless the mortgagor also were in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose.")
More on the Relationship between Article 9 and Article 3

- § 3-602(a) ("[A] [negotiable] instrument is paid to the extent payment is made by or on behalf of a party obligated to pay the instrument, and to a person entitled to enforce the instrument.")

- § 3-301 (defining under what circumstances a person is entitled to enforce an instrument)
Other Article 9 and Article 3 Issues

- Article 9 addresses the rights of the parties to the security agreement. It does not tell us who can enforce a negotiable instrument, which is an agreement between the obligor and payee (and subsequent persons entitled to enforce).

- Are we enforcing the Pooling and Servicing Agreement?

- Does the borrower get a free house if there is a problem with the ownership of the note?
Just a Reminder

• Please fill out the evaluation when you sign-out

• I will email you the PowerPoint and recording in a few days

• Thank you to our speaker!