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A COMPARATIVE ANALYSIS OF MORTGAGE LOAN ASSIGNMENTS AND A CALL FOR REFORM IN THE UNITED STATES

Julia Patterson Forrester Rogers*

I am honored to contribute to this Festschrift which recognizes the achievements of a remarkable man whom I have had the privilege to know—Professor Dr. Werner Ebke. Professor Ebke is a dedicated and distinguished scholar and teacher—he is also a lovely friend. We met when he was a visitor at SMU in 2002, and I have enjoyed our international friendship over the years. Although Germany has been his primary academic home, he has also had teaching appointments and other significant connections in the United States.

Professor Ebke has a myriad of contributions to international law, comparative law, corporate law, commercial law, and other areas of business law. One area in which we share an interest is financial markets. As a young assistant professor at SMU in the 1980s, he wrote on lender liability issues,¹ and more recently, he has written, among many other areas, on the international financial market crisis.² His English-language treatise on German law³ was helpful to me in writing this article, which compares American and German law governing the assignment of mortgage loans.⁴

The flow of capital into mortgage loans depends heavily on the ability to transfer those loans. In the United States, Germany, and other countries, mortgage loans are transferred on the secondary market.⁵ A loan originator may sell loans to a purchaser who intends to hold the loans

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¹ See Werner F. Ebke & James R. Griffin, *Lender Liability to Debtors: Toward a Conceptual Framework*, 40 SW. L.J. 775 (1986); Werner F. Ebke & James R. Griffin, *Good Faith and Fair Dealing in Commercial Lending Transactions: From Covenant to Duty and Beyond*, 49 OHIO ST. L.J. 1237 (1989).

² See, e.g., Werner F. Ebke, *Lehren aus der internationalen Finanzmarktkrise: Synthese und Ausblick* [Lessons from the International Financial Market Crisis: Synthesis and Future Prospects], in INTERNATIONALE FINANZMARKTKRISE. ERFABRUNGEN, LEHREN, HANDLUNGBEDARF 127 (Werner F. Ebke, et al. eds. 2011).

³ INTRODUCTION TO GERMAN LAW (Werner F. Ebke & Matthew W. Finkin eds., 1996).

⁴ I will use the terms “assignment” and “transfer” interchangeably in this article.

⁵ See generally Lina Aleknaite, *Why the Fruits of Capital Markets are Less Accessible in Civil Law Jurisdictions or How France and Germany Try to Benefit from Asset Securitization*, 5 DEPAUL BUS. & COMM. L.J. 191 (2007); Khaled Alharthi, *Assessing the Impact and Effectiveness of Saudi Arabia’s Real Estate Law on Secondary Markets: A Landmark Reform of Missed Opportunity?* (Sept. 18, 2020) (unpublished manuscript)(on file with author).

and collect payments or to a third party who will pool the loans and issue mortgage-backed securities to investors.⁶

In the United States, assignments of mortgage loans have created legal challenges and have been the subject of much litigation.⁷ The transfer and storage of large volumes of paper promissory notes, still the prevailing method of evidencing mortgage loans in the United States, is cumbersome, expensive, and subject to error. In addition, recordation of mortgage assignments in the real property records of the county in which mortgaged property is located is time-consuming and expensive. Furthermore, confusion and conflicts in the law governing mortgage loan assignments exist because the loans involve both real and personal property, which are subject to different legal rules, and because of a lack of uniformity in the law of the various states.

In Parts I and II of this article, I will review the basic mortgage loan transaction and the law applicable to mortgage loan assignments under American and German law. In Part III, I will compare American and German law, focusing on those issues in the assignment of mortgage loans that have been troublesome in the United States. Finally, I will draw conclusions from these comparisons and recommend reform in the United States.

I. American Law

A. Overview of the Mortgage Loan Transaction

To evidence a loan in the United States, the borrower executes a promissory note in which the borrower promises to repay the loan, typically in monthly installments. The note evidences the debt and includes the interest rate and payment terms. Although an obligation can be created electronically in the United States, an electronic promissory note cannot be a negotiable instrument.⁸ For this and other reasons, the American system for real estate finance is still primarily paper-based.⁹

⁶ See Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1325-26 (2006).

⁷ See *infra* notes 35-39 and accompanying text.

⁸ A negotiable promissory note must be in writing, which requires a tangible form. See U.C.C. §§ 1-201(b)(43), 3-103, 3-104 (AM. L. INST. & UNIF. L. COMM'N 2002).

⁹ See LAW OF ELECTRONIC COMMERCE § 9.03(D) (C.C.H. 2020).

To secure repayment of a mortgage loan, the borrower grants the lender a security interest in the property by executing a mortgage or deed of trust.¹⁰ A mortgage is a grant directly to the lender; a deed of trust is a grant to a trustee for the benefit of the lender. A mortgage or deed of trust secures a loan by giving the lender a right to foreclose on the property if the borrower defaults in making loan payments. A mortgage is generally foreclosed by judicial process; whereas a deed of trust may be foreclosed by power of sale held by the trustee.¹¹ This article will use the term “mortgage” to refer to both mortgages and deeds of trust.

Recordation of a mortgage in the real property records is not required for it to be valid as between the borrower and lender. However, a mortgage must be recorded in the county where the mortgaged property is located in order to perfect the lien and establish the lender’s priority as against competing interests in the property. When the borrower pays off the loan, a document must be recorded in the real property records to evidence the release of the lien.

Recording systems in most states do not provide any representation as to the ownership of land.¹² They simply provide a repository for recorded documents and an index of those documents to facilitate search of the records and the ability to make a determination as to ownership. In almost all counties, recorded documents are indexed by grantor and grantee names rather than by tract. Thus, constructing a chain of title to determine ownership interests in a tract is a cumbersome process.¹³ Lenders typically require a borrower to purchase title insurance to insure both the validity and the priority of the lender’s lien. Title insurance facilitates transfer of mortgage loans on the secondary market because investors may not be familiar with local title assurance practices.

¹⁰ In most states that security interest is a lien, but in a few “title theory” states, a mortgage transfers theoretical title to the lender. See Julia Patterson Forrester, *Still Crazy After All These Years: The Absolute Assignment of Rents in Mortgage Loan Transactions*, 59 FLA. L. REV. 487, 493 (2007). The law governing real estate transactions is primarily state law; thus, variations exist among the fifty states.

¹¹ Some states use a mortgage with power of sale.

¹² A few American jurisdictions allow counties to implement a title registration system, called the Torrens system, but even in those states, title registration is rare because of the expense. DALE A. WHITMAN ET AL., *THE LAW OF PROPERTY* § 11.15 at 819 (4th ed. 2019). When an owner does choose to have title registered, the county issues a certificate of title that identifies the owners of interests in the property. *Id.* at 820.

¹³ Title insurance companies often rely on private records indexed by tract to make determinations of ownership in connection with issuing title policies.

B. Assignment of Mortgage Loans

In the United States, loans are frequently transferred on the secondary market. A sale of a loan can occur on a “whole loan” basis, in which the purchaser buys the loan with the intent to hold it and collect the payments; a lender may sell participation interests in one large loan or in a pool of loans; or an originator may transfer a pool of mortgage loans to a party who will issue securities backed by the pool of loans.¹⁴ With securitization, the issuer will create a bankruptcy-remote corporation, trust, or other entity, called a special purpose vehicle, to hold the loans.¹⁵ Some mortgage-backed securities are pass-through securities with investors receiving their pro-rata share of payments made by the borrower; others are multi-class securities with different tranches receiving different types of payments. When loans are transferred or securitized, the owner of the loans often designates a servicer as the party to whom the borrower makes payments, particularly in residential transactions.

The assignment of a mortgage loan involves the transfer of different rights: 1) the right to enforce the promissory note and foreclose the mortgage in the event of a default, and 2) the ownership of the loan, which is the entitlement to the economic value of the loan, including the ultimate right to receive payments and proceeds of a foreclosure sale.¹⁶ The right to enforce a note may be transferred separately from the ownership of the note.¹⁷ The right to enforce a mortgage by foreclosure and the entitlement to foreclosure sale proceeds follow the corresponding rights in the note it secures.¹⁸

Article 3 of the Uniform Commercial Code (UCC) governs transfer of the right to enforce a negotiable promissory note.¹⁹ Article 9 governs transfer of ownership of a promissory note, whether negotiable or not, as well as the transfer of ownership rights in a mortgage.²⁰ Because every state has adopted the UCC with some variations, the law should be uniform. But the rules are complex, and some courts have been surprisingly inept at applying the UCC to transfers of

¹⁴ See Forrester, *supra* note 6, at 1325-26.

¹⁵ *Id.* at 1326.

¹⁶ See PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, REPORT: APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES 2-3, 11 (2011) [hereinafter PEB REPORT].

¹⁷ *Id.* at 11.

¹⁸ *Id.* at 12.

¹⁹ *Id.* at 14. Courts generally assume without discussion that a promissory note is a negotiable instrument, and this article will focus on negotiable promissory notes. Other rules apply to the transfer of the right to enforce a nonnegotiable note.

²⁰ *Id.*

mortgage loans,²¹ leading to litigation. In addition, rules relating to the foreclosure process vary considerably from state to state.

The concept of the negotiable instrument under Article 3 of the UCC is that the instrument is the embodiment of the obligation; thus, transfer of the right to enforce the obligation is primarily by transfer of possession of the instrument.²² Article 3 provides three methods for transferring the right to enforce a negotiable note. First and most importantly, a party who becomes the holder of a note is entitled to enforce it.²³ In order to become a holder, a party must have possession of the note and the note must be indorsed to that party, be indorsed in blank, or be payable to bearer.²⁴ The status of holder of a note not only gives the right to enforce the note but also shields the holder from some types of claims and defenses if the holder meets additional requirements to be a holder in due course.²⁵ Secondly, a non-holder with possession of a note and the “rights of a holder” has the right to enforce the note.²⁶ This provision allows enforcement of the note by a party who has possession of a note without a proper endorsement if the note was transferred for the purpose of giving that party the right to enforce.²⁷ Finally, a party may enforce a note without possession under limited circumstances if the note has been lost, stolen, or destroyed by providing a “lost note affidavit.”²⁸ Although endorsement and delivery of a promissory note is the preferred method for transferring the right to enforce, endorsement and delivery of a large pool of notes is logistically challenging.

Transferring ownership of a promissory note, the ultimate right to loan payments and proceeds, is a separate issue. The same party is often both the holder of a note and its owner, but that is not always the case. For example, a servicer may have the right to enforce a note but have a contractual obligation to deliver payments to the owner of the note. Although Article 9

²¹ *See id.* at 1.

²² *See* U.C.C. § 3-203 cmt. 1 (AM. L. INST. & UNIF. L. COMM’N 2002).

²³ *See id.* § 3-301 (listing persons who may enforce a note).

²⁴ *See id.* § 1-201(b)(21)(A) (defining holder).

²⁵ To be a holder in due course, the note must not have apparent irregularities and the holder must take the note for value, in good faith, and without notice of claims, defenses to payment, or other specified matters. *See id.* §§ 3-302. A holder in due course takes the note free from personal defenses such as fraud in the inducement, failure of consideration, mutual mistake, accord and satisfaction, and breach of warranty. *See id.* § 3-305. Commentators have argued that the holder in due course doctrine should be eliminated for consumer loans. *See, e.g.,* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503 (2002).

²⁶ *See* U.C.C. § 3-301.

²⁷ *See id.* § 3-203(a).

²⁸ *See id.* §§ 3-301, 3-309.

primarily governs security interests in personal property, including payment rights, it also governs the sale of payment rights.²⁹ Under Article 9, a party becomes the owner of a note by giving value to a seller who owns or has the power to transfer ownership.³⁰ In addition, either the seller must sign an agreement to transfer ownership of the note or the buyer must take possession of the note.³¹

When the ownership of a promissory note or the right to enforce it is assigned, the corresponding interest in the mortgage follows the note even if the mortgage is not formally assigned.³² The lien is accessory to the note and would be meaningless separate and apart from the note. Because the mortgage follows the note, an assignee who has a right to enforce the note also receives the right to enforce the mortgage. Some states require that an assignment of a mortgage be recorded in the real property records as a prerequisite to foreclosure.³³ But if a buyer fails to get a written assignment in recordable form, Article 9 provides a method for the buyer to record the interest.³⁴

Even in states that do not require recordation of an assignment prior to foreclosure, a transferee of a note has good reason to record a written assignment of a loan. Recordation avoids the risk that the borrower and the original lender could conspire to record a release of the lien without paying the debt and sell the property to a good faith purchaser for value who would take free of the lien. In addition, in the event of foreclosure, a recorded written assignment provides a chain of title from the borrower to the foreclosure sale purchaser. Thus, recordation of a written assignment is a good practice.

²⁹ See *id.* § 9-109(a)(3) (AM. L. INST. & UNIF. L. COMM'N 1998). Article 9 uses confusing language to accomplish this. The term “security interest” is defined to include any interest of a buyer of certain rights to payment. *Id.* § 1-201(b)(35). “Collateral” is defined to include payment rights that have been sold. *Id.* § 9-102(a)(12). A “debtor” is defined to include a seller of a payment right, *id.* § 9-102(a)(28), and a “secured party” is defined to include a buyer, *id.* § 9-102(a)(73).

³⁰ See *id.* §§ 9-203(b)(1), (2).

³¹ *Id.* § 9-203(b)(3).

³² See *id.* § 9-203(g); RESTATEMENT (THIRD) OF PROP: MORTGAGES § 5.4(a)-(b) (AM. L. INST. 1997). A note and mortgage may be separated if the parties so agree, but that would be a very rare occurrence. See U.C.C § 1-302(a); RESTATEMENT (THIRD) OF PROP: MORTGAGES § 5.4(a)-(b), cmt. a; PEB REPORT, *supra* note 16, at 12 n.44.

³³ PEB REPORT, *supra* note 16, at 13.

³⁴ See U.C.C. § 9-607(b).

When a pool of mortgage loans is transferred, the expense and logistics of recording each assignment can be significant.³⁵ As a result, some of the major players in the secondary mortgage market created the Mortgage Electronic Registration System (MERS) to serve as mortgagee of record, thus avoiding the need to record an assignment each time a mortgage loan is transferred. Because MERS is not government created or sanctioned, it must operate within the recording systems of the various states by serving as nominee for the holder of a note. This method has caused confusion in courts and has led to many lawsuits across the United States.³⁶ In addition, other MERS practices, such as its initial policy of allowing foreclosures in its name, have led to additional litigation.³⁷ Most of the litigation has ultimately been resolved in favor of MERS,³⁸ but borrowers continue to raise MERS-related issues in litigation challenging foreclosures.³⁹

Another issue that arises in connection with transfers of mortgage loans occurs when a borrower does not receive notice of the transfer. Notice to the borrower of a transfer is not required, except for residential borrowers.⁴⁰ Furthermore, under the traditional “payment rule,” a borrower, who without notice of a loan transfer pays the assignor, does not discharge the debt. The borrower may only discharge the obligation by paying the party entitled to enforce the note.⁴¹ In theory, a prudent borrower would ask to see the note before making a monthly payment or paying off the loan. This practice, of course, is not at all realistic because promissory notes are often held by a special purpose entity or in a faraway bank vault. Thus, borrowers may be at risk of paying the wrong party after a note is transferred.

The payment problem has been addressed as a practical matter for residential borrowers by federal statute that requires servicers to notify the borrower in writing of a transfer of the servicing.⁴² In addition, Article 3 was amended in 2002 to protect borrowers who have not

³⁵ Dale A. Whitman, *A Proposal for a National Mortgage Registry: MERS Done Right*, 78 MO. L. REV. 1, 37-38 (2013).

³⁶ See, e.g., *Farkas v. GMAC Mortg.*, 737 F.3d 338 (5th Cir. 2013). See also Whitman, *supra* note 35, at 41-42.

³⁷ See, e.g., *Martins v. BAC Home Loans Servicing*, 722 F.3d 249 (5th Cir. 2013). See also Whitman, *supra* note 35, at 43-45.

³⁸ See Whitman, *supra* note 35, at 42.

³⁹ See, e.g., *Jordan v. U.S. Bank Home Mortg.*, 820 Fed. Appx. 314 (2020).

⁴⁰ See *infra* note 42.

⁴¹ U.C.C. § 3-602 (1990).

⁴² See 12 U.S.C. § 2605(b), (c) (requiring both former and new servicers to notify a borrower of change in servicing).

received notice of the transfer of a note.⁴³ However, only twelve states have adopted the revision at this writing.⁴⁴

II. German Law

In Germany, commercial real estate receivables including real estate loans, leases, and proceeds of sale may be securitized.⁴⁵ As with securitization in the United States, the assets are transferred to a bankruptcy-remote entity.⁴⁶ However, much of the capital for real estate loans in Germany, both residential and commercial, comes from the sale of mortgage bonds (*Pfandbriefe*).⁴⁷ Mortgage bond banks make real estate loans and raise funds by issuing mortgage bonds backed by the loans.⁴⁸ The mortgage bonds are regulated under the *Pfandbrief* Act, and loans in the pool backing the bonds are subject to strict requirements including requirements as to loan-to-value ratio and property insurance.⁴⁹ A pool of loans backing the mortgage bonds is treated as a special asset of the mortgage bond bank and is protected from other creditors of the bank and against insolvency of the bank.⁵⁰ Thus, the loans do not need to be transferred to a special purpose entity.

In Germany, the loan relationship is created by the parties entering into a loan agreement.⁵¹ The loan agreement provides the interest rate, payment terms, and other loan terms.⁵² A loan agreement is not required to be in any particular form⁵³ and can be electronic.⁵⁴

⁴³ See U.C.C. § 3-602(b).

⁴⁴ See Unif. Law Comm., *UCC Article 3, Negotiable Instruments and Article 4, Bank Deposits, Amendments*, <https://www.uniformlaws.org/committees/community-home?communitykey=d6a2022c-ae5d-4fda-baf5-c1628a68168e&tab=groupdetails> (last visited Nov. 9, 2020).

⁴⁵ See Dennis Elchwald, *Financing Real Estate—Concepts and Collateralization*, in REAL ESTATE INVESTMENTS IN GERMANY: TRANSACTIONS AND DEVELOPMENT § 4.4.3 (Michael Mutze et al. eds., 2nd ed. 2012); Frank Nickel, *Commercial Property Financing*, in UNDERSTANDING GERMAN REAL ESTATE MARKETS § 4.2 (Tobias Just & Wolfgang Maennig eds., 2017).

⁴⁶ Elchwald, *supra* note 45, § 4.4.3.

⁴⁷ *Id.* § 4.5; Nickel, *supra* note 45, § 4.2 Fig. 4.

⁴⁸ Elchwald, *supra*, § 4.5; Nickel, *supra*, § 4.1.

⁴⁹ See Elchwald, *supra*, § 4.5; Nickel, *supra*, § 4.1.

⁵⁰ Nickel, *supra*, § 4.1.

⁵¹ Elchwald, *supra*, § 4.5.3.2.

⁵² *Id.* § 4.5.2.

⁵³ *Id.* § 4.5.

⁵⁴ See Florian Ehrich & Jannis Werner, *Use of Electronic Signatures in the German Real Estate Industry* § 6.1 (2020), available at <https://www.jdsupra.com/legalnews/use-of-electronic-signatures-in-the-51230> (last visited Nov. 9, 2020).

The loan obligation is governed by the law of obligations in the German Civil Code (BGB), but security interests are governed by property law.⁵⁵

Germany has two different methods for creating a security interest in real estate—the mortgage (*Hypothek*), which is an accessory security interest, and the land charge (*Grundschild*), which is a non-accessory security interest.⁵⁶ Both types of security interest may be either certificated or uncertificated.⁵⁷ Both secure a loan by allowing the owner of the interest to sell the pledged property in accordance with prescribed procedures if the borrower fails to make payments, and both take priority over a third party’s interest that is later established.⁵⁸

The creation of a security interest in real estate of either type must be registered in the land register.⁵⁹ The land register, which is managed by the local court, shows the ownership of a tract of land and the rights of other parties in the land,⁶⁰ similar to the Torrens system available in a few American states.⁶¹ In Germany, registration is a requirement for the security interest to be effective.⁶²

The mortgage, as an accessory security interest, is attached to the receivable that it secures;⁶³ thus, the German mortgage, like the American mortgage, follows the debt. The land charge, as a non-accessory security interest, can be created independent of any particular claim.⁶⁴ If a land charge is to secure a loan, the parties will execute a security purpose agreement under the law of obligations to create the connection.⁶⁵ The land charge is much more commonly used than the mortgage⁶⁶ and will be the focus of the remainder of this discussion. Reasons for its prevalence include its flexibility, the fact that it is not affected by a defect in the secured claim,

⁵⁵ See Stefan Henkelmann & Martin Scharnke, *Germany in INTERNATIONAL COMPARATIVE LEGAL GUIDES: SECURITISATION* 133, § 4.1 (Rupert Wall ed., 13th ed. 2020).

⁵⁶ *Id.* § 4.3.

⁵⁷ *Id.*

⁵⁸ Jurgen Kohler, *The Law of Rights in rem*, in *INTRODUCTION TO GERMAN LAW* 241 (Werner F. Ebke & Matthew W. Finkin eds., 1996).

⁵⁹ See *id.*, at 236-37.

⁶⁰ See Maximilian Clostermeyer, *2020 GTDT: Real Estate: Germany*, *GETTING THE DEAL THROUGH: REAL ESTATE* §§ 2, 3 (2020).

⁶¹ See *supra* note 12.

⁶² Kohler, *supra* note 58, at 237; Elchwald, *supra* note 45, § 4.5.3.2, at 94.

⁶³ Henkelmann & Scharnke, *supra* note 55, § 4.3.

⁶⁴ Elchwald, *supra* note 45, § 4.5.3.1, at 94.

⁶⁵ *Id.*, at 95.

⁶⁶ *Id.*

and its enforceability without proof of the secured claim.⁶⁷ A land charge does not automatically terminate upon payment of the debt and therefore must be reassigned to the property owner.⁶⁸

Unlike the American mortgage, a land charge does not follow an assignment of the debt and must be assigned separately. The method of assigning a land charge depends on whether it is certificated or uncertificated.⁶⁹ Uncertificated land charges are transferred by agreement and require registration of the transfer with the land register in order to be effective.⁷⁰ Registration can be expensive,⁷¹ with the cost based on the amount of the land charge.⁷² Certificated land charges are transferred by agreement and delivery of the land charge certificate.⁷³ Registration is not required.⁷⁴ Lenders may want to avoid registration both because of the cost and to avoid giving the obligor notice of the transfer.⁷⁵ If the land charge is uncertificated, the seller of the land charge may hold it in trust for the buyer to avoid the registration requirement.⁷⁶

In Germany, receivables can generally be transferred without the consent of the obligor unless the agreement prohibits assignment.⁷⁷ Furthermore, except for consumer loans, German law does not generally require that a borrower be notified of an assignment of a loan.⁷⁸ However, until notice is provided, the borrower may discharge the obligation by paying the assignor.⁷⁹ Furthermore, the borrower may generally raise defenses against the assignee that the borrower had against the assignor.⁸⁰

III. Comparison and Lessons

American and German law have similarities and differences that can shed light on some of the problems that arise under American law. In both the United States and Germany, the law

⁶⁷ *Id.*

⁶⁸ *Id.* § 4.5.3.5.

⁶⁹ *Id.* § 4.5.3.4.

⁷⁰ *Id.*

⁷¹ Henkelmann & Scharnke, *supra* note 55, § 4.3.

⁷² *See* Aleknaite, *supra* note 5, at 226.

⁷³ Henkelmann & Scharnke, *supra* note 55, § 4.3.; Elchwald, *supra* note 45, § 4.5.3.4.

⁷⁴ Elchwald, *supra* note 45, § 4.5.3.4.

⁷⁵ Henkelmann & Scharnke, *supra* note 55, § 4.3.

⁷⁶ *Id.* The law is not clear that these trust agreements would be upheld if the seller becomes insolvent. *Id.* “For that reason, the German Banking Act . . . contains special provisions for refinancing register transactions which allow for the creation of insolvency remote trust arrangements.” *Id.*

⁷⁷ *Id.* § 4.4.

⁷⁸ *Id.*

⁷⁹ *Id.* In addition, a borrower may set off a claim against the assignor until notified of the transfer. *Id.*

⁸⁰ *Id.*

governing mortgage loans and their assignment involves the interaction of two different bodies of law—in the United States, the Uniform Commercial Code and states’ real property law, and in Germany, the law of obligations and the law of property. This interaction seems to work better in Germany than in the United States where reform is needed. A difference between the countries is the variations in law among states in the United States, suggesting that a federal solution in the United States would be preferable.

There are similarities and differences between the two countries in the securitization of loans. In both countries, commercial loans backing securities are held by a special purpose entity, necessitating at least one transfer. However, in Germany, many residential loans are made by mortgage bond banks that can issue their own bonds, without the necessity of transferring the loans to another party or to a special purpose vehicle.⁸¹ In the United States, almost every residential loan is transferred one or more times.

Another difference is the method of creating the obligation—the American negotiable instrument versus the German loan agreement. In the United States, the law of negotiable instruments, with its notion that the obligation is embodied in the instrument and transferred by possession of the instrument, creates logistical problems for storage and transfer of paper promissory notes that make up pools of residential mortgage loans. German loan agreements do not similarly embody the obligation and can be electronic.⁸²

Still another difference is the relationship between the security and the debt—the American mortgage that follows the note versus the non-accessory German land charge that does not. In Germany, the land charge does not automatically follow the obligation, and transfer of an uncertificated land charge requires registration with the land register.⁸³ In the United States, recordation of an assignment is not required to effectuate a transfer, but courts have struggled with understanding the relationship between UCC rules and real property principles.

In both countries, systems of real property records—recordation in the United States and the registration in Germany—create logistical problems and expense in the transfer of real estate loans. In the United States, major players in the secondary market created MERS to avoid

⁸¹ See *supra* notes 47-50 and accompanying text.

⁸² See *supra* notes 51-54 and accompanying text.

⁸³ See *supra* notes 69-72 and accompanying text.

recording multiple assignments of a loan. In Germany, because mortgage bond banks issue their own bonds, the loans are not transferred, avoiding the registration issue. When a loan is transferred in Germany, parties may avoid registration by using certificated land charges or by leaving land charges in the hands of a trusted originator.⁸⁴

Both countries require notices relating to assignments for consumer borrowers but not otherwise. However, Germany protects a borrower who pays the assignor before receiving notice of an assignment.⁸⁵ The United States still has a rule in many jurisdictions that would fail to discharge a debt if a borrower without notice pays the assignor—a rule that clearly calls for change.

A solution to these problems in the United States is in the works but has not yet been adopted. The Federal Reserve Bank of New York drafted a bill, with input from the American Law Institute, the Uniform Law Commission, MERS, and other interested parties, that if passed by Congress would create a National Mortgage Note Repository.⁸⁶ Amendments to UCC Articles 3 and 9 necessary to integrate with the mortgage registry were approved by the American Law Institute and the Uniform Law Commission in 2018, although the UCC amendments would not take effect until a federal law creating the registry is passed by Congress.⁸⁷

The National Mortgage Note Repository Act would create a registry for residential mortgage loans.⁸⁸ The holder or other person entitled to enforce a mortgage note could submit the note for registration.⁸⁹ Under the proposed Act, a requirement for submission would be that the mortgage must be recorded in the real property records in the county where the mortgaged property is located.⁹⁰ Upon receipt of a mortgage note, the operator of the repository would convert the note to an electronic record.⁹¹ Once a negotiable note was converted, the instrument would no longer embody the obligation,⁹² but the resulting electronic mortgage note would still

⁸⁴ See *supra* notes 73-76 and accompanying text.

⁸⁵ See *supra* note 79.

⁸⁶ See LAW OF ELECTRONIC COMMERCE § 9.03(D)(3) (C.C.H. 2020).

⁸⁷ *Id.*

⁸⁸ See National Mortgage Note Repository Act of 2018 (Jan. 28, 2018 draft) (on file with author) [hereinafter Repository Act Draft].

⁸⁹ *Id.* § 7(b).

⁹⁰ *Id.* § 7(c)(1).

⁹¹ *Id.* § 7(c)(3).

⁹² *Id.* § 8(a).

be treated as a negotiable instrument.⁹³ The person entitled to enforce the note as identified by the registry would retain the same rights to enforce the note and could still meet the requirements to be a holder in due course.⁹⁴ The proposed Act provides for tracking of transfers, modifications, and discharge of electronic mortgage notes.⁹⁵ Transfers would not be recorded in real property records. Borrowers would receive notices and could obtain information from the registry regarding ownership, rights to enforce, and servicing of a loan.⁹⁶ The Act would preempt inconsistent UCC provisions in states that had not passed the UCC amendments.⁹⁷

IV. Conclusion

The primarily paper-based system for residential mortgage loans in the United States is inefficient and subject to errors, and it creates unnecessary litigation. Furthermore, MERS has not satisfactorily eliminated issues relating to recordation of mortgage assignments. The United States needs a big solution for a big problem. Germany, on the other hand, because of its reliance on mortgage bonds to provide funding for mortgage loans and because it does not have the concept of the negotiable promissory note, has not seen the problems that we have had in the United States. The German system seems to be working; the American system is not.

Congress should pass a National Mortgage Note Repository Act, and states should adopt the corresponding revisions to the UCC. Other types of financial instruments have been tracked and transferred electronically with great success. The mortgage repository system would identify the party entitled to enforce a mortgage note, resolving the payment problem for residential borrowers and reducing litigation relating to foreclosures for lenders. It would facilitate the transfer of residential mortgage loans without the need to physically transport notes, and it would eliminate the need to record mortgage assignments in the real property records, thus reducing expenses and logistical problems of transfers. It would insure that uniform laws are applied to assignments of residential mortgage loans. In sum, it would benefit borrowers, mortgage lenders,

⁹³ U.C.C. § 3-104 (AM. L. INST. & UNIF. L. COMM'N, Tentative Draft No. 1, 2018); Repository Act Draft, *supra* note 88, § 9(a)(1)(A).

⁹⁴ U.C.C. §§ 3-301, 3-302 (Tentative Draft No. 1, 2018); Repository Act Draft, *supra* note 88, § 9(a)(1)(C).

⁹⁵ Repository Act Draft, *supra* note 88, §§ 10, 11, 12.

⁹⁶ *Id.* §§ 16, 17,

⁹⁷ *See id.* § 5(a)(9).

and other mortgage market participants and would lead to more efficient and better operation of the residential mortgage market.