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MERS System Derailed in the State of Washington

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In the 1990s, the mortgage industry established a private, off-record system for tracking ownership of loans secured by mortgages. They called it the Mortgage Electronic Registration System, Inc., or "MERS" for short. The idea was to create a streamlined process for tracking ownership of mortgages and the loans they secure. The traditional way was to record an assignment of the mortgage (or deed of trust) with the county each time the loan was sold from the originator onward. That can be a cumbersome and costly process for loans are re-sold several times. MERS was created to avoid this system.

In a nutshell, here is how the MERS system works:

1. Instead of recording a deed of trust showing the original lender as the beneficiary, the deed of trust shows MERS as the beneficiary in a capacity as "nominee" for the original lender. MERS has no ownership interest in the loan itself.

2. The loan is assigned a permanent 18-digit number called a Mortgage Identification Number, which MERS uses to track ownership of the loan as it is sold, transferred or packaged into mortgage-backed securities.

3. No assignment of the deed of trust is recorded with the county as the loan is sold, transferred, etc. As far as the public records are concerned, the beneficiary of the loan remains constant; namely MERS.

The upside to this system is that it facilitates secondary markets in mortgage debt. Being able to avoid the traditional costs of recording transactions with the local county provides liquidity to what otherwise is a fairly illiquid asset.

However, the Washington Supreme Court recently issued a decision that puts the enforceability of these "MERS deeds" of trust into question. The decision is *Bain v. Metropolitan Mortgage Group, Inc.*

In *Bain*, the Washington Supreme Court held that MERS cannot be a lawful "beneficiary" of a deed of trust when it acts as a nominee for the lender. Washington's deed of trust act defines "beneficiary" as the actual holder of the promissory note (or other obligation) secured by the deed of trust. Since MERS does not hold the promissory note when it is appointed nominee beneficiary, MERS cannot be a lawful beneficiary under Washington's deed of trust act, according to the court's decision.

Unfortunately, the court did not answer the follow-up question, which is: If MERS is not a lawful beneficiary, what does that mean from a legal standpoint? Can the deed of trust still be enforced? And if so, how?

The court declined to answer these questions concluding the record before it was not sufficiently developed to address them. The opinion does, however, suggest that a MERS deed of trust probably cannot be enforced non-judicially (via a

trustee's sale), but probably can still be enforced judicially (via a lawsuit).

There is bound to be a response to this decision—perhaps in the form of a legislative amendment to the deed of trust act. Several interests groups submitted friends of the court briefs to the Washington Supreme Court, including the Washington Bankers

Association. But for now, the enforceability of MERS deeds of trust in Washington is put into question—at least as far as being able to foreclose on them non-judicially goes.

It should be noted that about a month before the Washington Supreme Court issued its decision in *Bain*, the Oregon Supreme Court issued a decision of its own,

which appears to have derailed the MERS system in Oregon as well, albeit for slightly different reasons.

If you have any questions about banking or finance, please feel free to contact **Magnus Andersson** at (425) 894-4362.

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Magnus R. Andersson's practice focuses on real estate, construction and banking. He has over 10 years' experience handling property transactions, financing, construction, and leasing matters. Magnus has also resolved numerous disputes on behalf of property owners, contractors, banks and other businesses over the years. Many of Magnus' clients are small to mid-sized companies based in the Puget Sound region of Washington State, but he also works with publicly-traded companies as well as individuals who own real estate.