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Dirty REMICs, Revisited

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Before setting pen to paper in drafting our response to Joshua Stein's "Different View," we had to look down to see whether the shoe was on the other foot. A preeminent real estate lawyer was criticizing two law professors for advocating for strict construction of documents and statutes and for thinking too small. And that practitioner was also advocating for a revolution in real estate finance, for sweeping away borrower protections that had been developed over a millennia under our common law system, and for replacing the status quo with an efficient system designed by the financial industry, along the lines of the Mortgage Electronic Recording System (MERS). We expect to find that kind of thinking in law review articles! Because our different approaches so clearly demonstrate the opposing views in the debate over the future of residential real estate finance, we will first review those differences and then highlight where they converge. In the end, we hope that real estate lawyers of all stripes can come together with an approach to residential real estate finance that is efficient and also provides reasonable protections for homeowners.

Those Troublesome Technical Requirements!

Stein asks whether "those troublesome technical requirements give anyone any protection that matters?" Before going to the substance of the question, we would first ask, would Mr. Stein waive a strict notice requirement contained in a commercial lease if doing so would harm his client? If not (and we are pretty sure it is "not"), why would a different rule apply with homeowners? Certainly residential lenders don't routinely waive "troublesome" requirements such as the one that requires monthly payments to be made by a certain date in order to avoid a late penalty.

As to the substance of Mr. Stein's inquiry, we would answer – yes, technical requirements matter. As just one example, only certain parties can foreclose on a mortgage. Technical state law requirements ensure that the plaintiff is one of those parties and protect borrowers from defending actions by parties without standing to foreclose. Again, I am confident that Mr. Stein would insist on such a technical requirement if it were his commercial client who was faced with a foreclosure. What is good for the commercial goose is good for the residential gander as far as we can tell.

Another example: Stein's dismissal of the relevance of the "holder in due course" status in residential mortgage finance ignores the key role it played in the debate over state anti-predatory lending legislation throughout the Boom years in the early 2000s. *See generally* David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market*, 33 FLA. ST. U. L. REV. 985 (2006).

And another: Stein argues that the risk of a second foreclosure brought by a true owner of the debt would "typically provide a complete defense against foreclosure." That misstates the real issue. The real issue is whether a borrower could have to defend an action to collect the debt brought by a true owner after another party brought a successful foreclosure action. The clear answer is yes, they would need to pay for the defense of such a suit. And, in Arizona at least, they might be liable for that debt to the true owner under certain circumstances! *See* William K. Akina, David J. Reiss, and Bradley T. Borden. *Show Me the Note!*, WESTLAW JOURNAL BANK & LENDER LIABILITY 3 (June 3, 2013) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2274977 and http://works.bepress.com/david_reiss/63)

And a last one: Stein argues that we are mistaken in calling for the IRS to enforce the REMIC rules as they are written so that the Treasury can collect revenue properly due to it by non-compliant purported REMICs. The general tax enforcement policy is that if you do not comply with the strict requirements for avoiding taxation, you will pay tax on the transaction. We do not understand why Stein would have a special rule for REMICs. It makes us wonder whether he believes that commercial real estate transactions should be generally exempt from strict compliance with the Internal Revenue Code. For instance, the period for identifying properties for like kind exchanges under section 1031 of the Internal Revenue Code could be "a few months" instead of 45 days after the transfer of the relinquished property and the exchange could happen "180 days, give or take," after that transfer. That would be very "efficient" for investors too!

Law Professors Thinkin' Small

Stein argues that we should sweep away a lot of the technical requirements relating to mortgages and adds that we "might even go a few steps further and establish a central registrar to keep track of who owns mortgage loans and who has the right to foreclose." As Stein acknowledges, this is a lot like the Mortgage Electronic Registration System (MERS). But Stein does not acknowledge any of the controversy surrounding MERS. MERS was created by private interests such as Fannie, Freddie and the Mortgage Bankers Association. They did not believe that they needed the approval of federal, state or local governments, or anyone else for that matter, to dramatically change the recording system for mortgages. Things appeared to go swimmingly for a few years, but the shortcuts that MERS took had a toll on it. Stein's takeaway: do it again.

Our takeaway: if we do it again, let's remember that process matters. Consult with all of the stakeholders, including those representing borrowers' interests. Promote efficiency, but respect the body of law that has developed around mortgages. Accept that consumer protection is not only the right thing to promote but that consumer protection also promotes responsible lending.

The Future of Residential Real Estate Finance

We have poked fun at Mr. Stein a bit for the double standard we believe he has for residential and commercial real estate finance transactions. But we are grateful that he has taken our argument seriously and agree with him that the stakes are high for borrowers and for the real estate finance industry. We agree that structural reform that would seek to modernize the system of residential real estate finance is called for. But until that reform is in place, we will continue to advocate for the enforcement of procedural protections and for strong tax enforcement.

We would also emphasize that a thoughtful process for adopting proposed reforms is not only important to ensure that all stakeholders are represented but also for ensuring the long-term legitimacy of the new system. And we cannot emphasize enough how important we believe consumer protection is to a well-functioning residential real estate finance system. A thousand years of precedents in law and equity back us up on that.

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[*] Brad and David are professors at Brooklyn Law School. © 2013 Bradley T. Borden and David J. Reiss. This is a response to Joshua Stein, Dirt Lawyers Versus Wall Street: A Different View, PROBATE AND PROPERTY (forthcoming 2013) (available at https://docs.google.com/file/d/0BxUYhg0cYUOTdjdSMXd3OWoyNGc/edit), which in turn is a response to Bradley T. Borden & David J. Reiss, DIRT LAWYERS AND DIRTY REMICS, PROBATE AND PROPERTY 12 (May/June 2013) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2209863).