Spring 2013

Certainty of Title: Perspectives After the Mortgage Foreclosure Crisis on the Essential Function of Effective Recording Systems

Donald J. Kochan

ARKANSAS LAW REVIEW

VOLUME 66 NUMBER 1

CERTAINTY OF TITLE: PERSPECTIVES AFTER THE MORTGAGE FORECLOSURE CRISIS ON THE ESSENTIAL ROLE OF EFFECTIVE RECORDING SYSTEMS

DONALD J. KOCHAN

Reprinted from
ARKANSAS LAW REVIEW
Volume 66, Number 1

Certainty of Title: Perspectives After the Mortgage Foreclosure Crisis on the Essential Role of Effective Recording Systems

Donald J. Kochan*

I. INTRODUCTION

A venerable maxim in our law is expressed in Latin as *nemo dat quod non habet*—one who does not have cannot give.[1] The truth of this maxim, concerning the authority to transfer possession, can hardly be questioned, but when employed, we must answer a fundamental, ancillary question—what does one have that can be given, conveyed, or otherwise transferred? Both the transferor as the claimed owner of the thing, the potential transferees that want the thing, and all others who wish to rely on the thing as an element of their transactions will need to determine exactly what is owned and whether the one claiming to own it truly *owns* it. The answer requires a high degree of certainty before any efficient economic interactions with or exchanges of the thing can take place.[2] Property recording

---

*Professor of Law, Chapman University School of Law; J.D., Cornell Law School, 1998; B.A., Western Michigan University, 1995. The author thanks James Bilek and Marissa Cale for research assistance. Special thanks to Jennifer Spinella for editorial assistance. This article builds substantially on remarks made at a panel presentation at the 2011 National Lawyers Convention hosted by the Federalist Society. The remarks commented on the panelists' presentations, in particular the remarks of Hernando de Soto. Donald J. Kochan, Professor of Law, Chapman Univ. Sch. of Law, Address at the 2011 National Lawyers Convention, Property Rights: The Forgotten Spark of the Arab Spring (Nov. 12, 2011), *available at* http://www.fed-soc.org/publications/detail/property-rights-the-forgotten-spark-of-the-arab-spring-event-audiovideo.

1. *See* BLACK'S LAW DICTIONARY 1849 (9th ed. 2009) ("No one gives what he does not have."). *See also* Mitchell v. Hawley, 83 U.S. 544, 550 (1872) ("No one in general can sell personal property and convey a valid title to it unless he is the owner or lawfully represents the owner. *Nemo dat quod non habet*."). A related maxim is also relevant here: *nemo plus juris ad alienum transferre potest quam ipse haberet*, meaning "No one can transfer a greater right than he himself might have." BLACK'S LAW DICTIONARY 1850 (9th ed. 2009).

2. Hernando de Soto, *What If You Can't Prove You Had a House?*, N.Y. TIMES, Jan. 20, 2006 [hereinafter de Soto, *What If*],

systems play a pivotal, market-facilitating role for the players engaged in real-estate transactions, the judiciary, and other members of the general public by informing them about the true nature of ownership of real property. This information is valuable to all of society, not just the immediate borrowers and lenders.[3] This article explores the essential characteristics of such recording systems which provide certainty of title and takes a tour through the mortgage-foreclosure crisis to determine where adherence to and respect for these systems' roles broke down.[4]

Part II provides a brief background on the real property recording systems in the United States. It explains the foundational values of certainty, predictability, and verifiability that underlie the system of recording interests in property. After establishing the importance of certainty of title, Part III analyzes the deficits of certainty of title evident in title identification and verification during the recent mortgage-foreclosure crisis.[5] It provides

---

www.nytimes.com/2006/01/20/opinion/20iht-edsoto.html ("We take the law for granted; but without legal documents, people do not exist in a market. If property, business organizations and transactions are not legally documented, they are fated to remain forever uninterpreted and society cannot work as a whole.").

3. *See generally* Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. REV. 727, 743-44 (2009) [hereinafter Korngold, *Legal and Policy Choices*]. Gerald Korngold explains the broad public need for access to title information:

> Current and potential participants in land transfer and finance transactions need information so markets can operate efficiently and fairly, thus benefiting those particular players as well as society. There is therefore a legitimate concern if unrecorded mortgage assignments in secondary market transactions are not placed on the public record. . . .
>
> Actually, this is an issue that predates MERS . . . .

Id. at 743-44 (footnotes omitted).

4. For some basic background on the mortgage-foreclosure crisis and related systemic failures in recording and identification of ownership interests, see Raymond H. Brescia, *Leverage: State Enforcement Actions in the Wake of the Robo-Sign Scandal*, 64 ME. L. REV. 17, 18-23 (2011) (providing background on mortgages, foreclosures, recording acts, and securitization); Korngold, *Legal and Policy Choices*, *supra* note 3, at 729-30 (providing the basic historical background of mortgages and securities).

5. *See generally* Steven L. Schwarcz, *Understanding the Subprime Financial Crisis*, 60 S.C. L. REV. 549, 551 (2009) [hereinafter Schwarcz, *Understanding*] (explaining the background of the subprime mortgage crisis). Schwarcz explains that "[t]he financial crisis resulted from a cascade of failures, initially triggered by the historically unanticipated depth of the fall in housing prices." *Id*.

background on the trends toward greater fragmentation of property interests in the United States, especially as evidenced by the securitization of mortgages. Part III explains that, with the securitization of mortgages and the fragmentation of ownership interests, some of the uncertainty in our current ownership structures contributes to legal and market difficulties. As Peruvian economist Hernando de Soto describes it, there is a "legal challenge because American and European governments allowed economic activity to cross the line from the rule-bound system of property rights, where facts can be established, into an anarchic legal space, where arbitrary interests can trump facts and paper swirls out of control."[6]

After slicing, dicing, and julienning title into many pieces, it is difficult during mortgage foreclosures for the courts and others to ensure the inclusion of all appropriate ownership interests in the property or to properly dispose of the property or proceeds from its sale after such actions. These failures have exacerbated the mortgage-foreclosure crisis—delaying the resolution of foreclosure cases, tying up property in limbo, adding high transaction costs, undoubtedly resulting at times in improperly allocating proceeds from foreclosure sales, and ultimately leaving some property open and susceptible to title challenges that stymie investment that is usually incentivized only with a high level of certainty of ownership and confidence in the durability of a property transfer.[7]

---

6. Hernando de Soto, *The Destruction of Economic Facts*, BUSINESSWEEK, May 2, 2011, at 60, 63 [hereinafter de Soto, *Destruction*], *available at* http://www.businessweek.com/magazine/content/11_19/b4227060634112.htm.

7. David Dana explains the "immense" problem regarding chain of title after the crisis:

> [A]s a result of the housing boom, the rise in more complicated securitization, sloppy servicing, and the embrace of the now somewhat infamous Mortgage Electronic Registration Service by financial institutions, the servicers of mortgages in default sometimes cannot identify who owns the mortgage or the note at any given point in time, including the point at which the power-of-sale foreclosure process or the foreclosure judicial action commences. As commentators have observed, the unresolved chain-of-title problem in both notes and mortgages appears to be immense.

David A. Dana, *Why Mortgage "Formalities" Matter*, 24 LOY. CONSUMER L. REV. 505, 513 (2012) (footnote omitted).

The difficulties experienced during the ongoing housing crisis provide some evidence of the limited capacity of the current system to deal with proper recordation after complex fragmentation.[8] The fragmentation of property interests facilitated by mortgage-backed securities and other financial instruments has created or at least exacerbated such difficulties. Despite attempts to "keep track" and therefore "keep formal" the ownership interests, failures abound. There are no easy solutions. Private recording systems such as the Mortgage Electronic Registration Systems, Inc. (MERS) have demonstrated problems with reliability and transparency—key elements of any proper recording system.[9] As part of its focus on lessons to be learned from the mortgage-foreclosure crisis, this article explores the failure of MERS and the limitations of present recording systems to keep track of ownership interests in property.

Part IV explores the role that certainty of title plays in our property system and in a functioning financial market for property and mortgages and, conversely, the role that uncertainty of title has played in making the mortgage-foreclosure crisis difficult to resolve.[10] It identifies certainty as an independent concept of law worthy of separate attention; certainty is a foundational value, necessary for the operation of an assortment of legal rules. Part IV defends the proposition that *certainty of title* in particular is a fundamental element in any reliable property system. Part IV benefits from an analysis of the work of Hernando de Soto and others who have demonstrated the importance of formal systems of property recordation.[11]

---

8. Nestor M. Davidson & Rashmi Dyal-Chand, *Property in Crisis*, 78 FORDHAM L. REV. 1607, 1635-36 (2010) (discussing "the increasing abstraction and fragmentation of ownership spawned by securitization").

9. Korngold, *Legal and Policy Choices*, *supra* note 3, at 743-44 (discussing "the importance of transparency in the recording system").

10. Hernando de Soto, Opening Ceremony at the Int'l Bar Ass'n Annual Conference (Oct. 12, 2008), *in Law Connects*, INT'L B. NEWS, Dec. 2008, at 14, 18 [hereinafter de Soto Speech] ("That's exactly what is now happening in the sub-prime crisis: you don't know who owns what. That's the crisis, not lack of money.").

11. *See, e.g.*, HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 39-67 (2000) [hereinafter DE SOTO, MYSTERY]; HERNANDO DE SOTO, THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD 152-63 (1989) [hereinafter DE

When a crisis strikes, such as the housing market crash, there is a need and an opportunity to examine core concerns of legal architecture.[12] Some scholars have recognized that property norms have been downplayed as a primary subject of concern in much of the post-crisis literature.[13] Certainly, too little attention has been given to the core fundamentals of recording. It has long been recognized, even before the crisis, that recording systems in the United States are in need of modernization and reform.[14]

Part V of this article surveys some possible solutions to the recordation problems and the assault on certainty effectuated by complex financial fragmentation of property. Any solutions must be based on this article's proposition that the proper recording of title, provided by a well-functioning set of legal rules and government institutions, is consistent with the obligations of good government. In conclusion, the article introduces some of the legal architecture necessary to overcome the problems associated with the fragmentation of property interests and the securitization of mortgages. It presents an initial framework needed to resolve these problems. Any such reforms must fully utilize the possibilities of recording or registering title while maintaining some of the positive aspects of securitization

---

SOTO, OTHER PATH]. *But see* Rashmi Dyal-Chand, *Exporting the Ownership Society: A Case Study on the Economic Impact of Property Rights*, 39 RUTGERS L.J. 59, 62 (2007) (disputing de Soto's claims as overstated regarding the "connection between property formalization and greater social welfare"). For other works analyzing de Soto, see HERNANDO DE SOTO AND PROPERTY IN A MARKET ECONOMY (D. Benjamin Barros ed., 2010) (collection of papers critically evaluating de Soto's theories and claims).

12. Davidson & Dyal-Chand, *supra* note 8, at 1607 ("In times of crisis, however, fundamental questions about the nature of ownership and the balance between the individual and the state instantiated in the structure of property rise rapidly to the surface. Our current economic crisis—the deepest since the Great Depression—is no exception." (emphasis omitted)).

13. *Id.* at 1607-08 ("Although scholars have begun to grapple with the causes and some of the particular consequences of the current crisis, there has been relatively little theoretical engagement with the role of property norms in the origins of, and in the regulatory response to, the crisis." (emphasis omitted)).

14. *See, e.g.*, Dale A. Whitman, *Are We There Yet? The Case for a Uniform Electronic Recording Act*, 24 W. NEW ENG. L. REV. 245 (2002) (discussing the mechanics of recording and analyzing reform proposals and prospects for and concerns with such efforts); Dale A. Whitman, *Digital Recording of Real Estate Conveyances*, 32 J. MARSHALL L. REV. 227, 227-28 (1999).

and the financial innovations that have recently emerged.[15]

II. A BRIEF INTRODUCTION TO THE RECORDING SYSTEMS

The identification of title is critical in any real property transaction. Title identifies who has authority to use and enjoy the property, to exclude others, or to give and exchange the property.[16] Of course, title is meaningless if it is not recognized and nearly meaningless if there is not some method to prove title with certainty. This is why we have principles and mechanisms of title assurance, including the system of recording where typically local records offices serve as repositories of information on title and transfers of property within a jurisdiction.[17] Every jurisdiction in the United States has some form of recording

---

15. Korngold explains the necessity for such balance:

> In recent years there have been important steps taken to modernize mortgage creation, transfer, and recording. The growth in the secondary markets spurred a number of these changes. Legislatures and courts need to address the problems that the subprime crisis and mortgage market collapse engendered. At the same time, they should be careful to preserve the positive changes in the law of mortgages that the secondary market has brought.

Korngold, *Legal and Policy Choices*, *supra* note 3, at 739.

16. Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 ST. LOUIS U. PUB. L. REV. 113, 120 (2009) ("Title is a legal construct that defines the ownership interest someone holds in an asset. In the context of homeownership, title allows one to determine who owns what property interests in a home, and then determine who has legal authority to use, enjoy, encumber, and transfer the property." (footnote omitted)).

17. Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 20-21 (2011), http://www.columbialawreview.org/wp-content/uploads/2011/03/19_Marsh.pdf (discussing the mechanics of recording, indexing, and the difficulties associated with the process). Consider also Way's discussion on the broad importance of title assurance mechanisms:

> One of the touchstones of real property security in the United States has been the creation of extensive title recording systems at the state level which create a written record of the chain of title. These public recording systems, along with quiet title actions, laws that extinguish ancient claims, and other property laws, favor the creation of clear and reliable property interests, while disfavoring ambiguous or contested ownership interests. Title insurance further facilitates the creation of secure title interests by insuring a property owner from third party claims to the property.

Way, *supra* note 16, at 121 (footnotes omitted).

or registration infrastructure for real property within its borders, differing in particulars but with many common characteristics.[18] These formal mechanisms for the recognition of real property ownership hold vital information available for public examination.[19] While recording systems and registration systems are distinct, the differences are largely not pertinent to the discussions in this article, as both are title assurance mechanisms that aim to provide a formal and authoritative mechanism for identifying, with a high level of certainty, ownership interests and priority within the title system. For the most part, however, this article refers to and discusses "recording" systems due to the dominant status of that form of title assurance in the United States.

The recording process is meant to ensure that both initial transfers of title to land and subsequent acts limiting, encumbering, or dividing interests in title are recorded. As Singer explains, "In general, deeds that convey title to land, long-term leases, mortgages, easements, and covenants may be recorded,"[20] and in many cases other legal consequences warrant that these interests in property should or must be recorded.

In the traditional, pre-securitization mortgage situation, when there was a lending institution and a homeowner and no other interested parties, a deed to both the land and the mortgage would typically be recorded at the public records office. The world would then be put on notice of the complete nature of the ownership, liens, and other encumbrances on title in the property. In those simpler times, recording was less difficult. But the purpose

18. Gerald Korngold, *Resolving the Intergenerational Conflicts of Real Property Law: Preserving Free Markets and Personal Autonomy for Future Generations*, 56 AM. U. L. REV. 1525, 1564 (2007) [hereinafter Korngold, *Resolving*] ("While the recording acts differ among the states in some respects, they share many common models, attributes, and goals."). It is beyond the scope of this article to discuss the differences between types of recording statutes, to compare the recording system with other methods of title assurance such as the Torrens system and registration, or to discuss the comparative merits of structuring the best system of state-backed title assurance.

19. *Id.* ("The recording acts and related rules were developed to establish a public system of land records that would protect ownership interests in land and accurately reflect that information for anyone to examine.").

20. JOSEPH WILLIAM SINGER, PROPERTY § 11.4.5 (3d ed. 2010).

of recording has always been the same—to provide reliable, verifiable ownership information in a centrally located, accessible, and identifiable place where anyone interested in learning the ownership status of property could obtain the relevant public information.[21] This function is even more important when the financial world makes it easy to create a dizzying array of transfers that are even harder to track.[22] In his book, Benito Arruñada, a Professor of Business Organization at Pompeu Fabra University, Barcelona, describes some of the vital functions of recording or registries:

> Protecting third parties without damaging owners is harder when contracts remain private. This is what happens in transactions such as mortgages or those involving companies, which lack verifiable consequences. History suggests that achieving both goals in these cases requires effective, independent, public registration of property rights or private contracts. Only such reliable registers can ensure that owners of resources have publicized their property rights (so that acquirers can find out about them before contracting) or have consented voluntarily to a weakening of their property rights with respect to innocent acquirers (so that owners cannot opportunistically renege from such consent). When purchasers of land and mortgage lenders rely for their contracts on the information filed with the registry, developed legal systems protect their acquisitions even against unregistered legal owners.[23]

The difficulty of tracing property ownership and transfers makes it even more useful to have a map of the transfers.[24]

---

21. *Id.*

22. Brescia, *supra* note 4, at 21-22 ("[P]ractices in the mortgage market over the last decade mean these [recording] protections are more important, not less. This phenomenon makes the problems revealed in the present scandal even more troublesome.").

23. BENITO ARRUÑADA, INSTITUTIONAL FOUNDATIONS OF IMPERSONAL EXCHANGE: THEORY AND POLICY OF CONTRACTUAL REGISTRIES 3-4 (2012) (noting that, once the financial crisis hit, observers started realizing that contractual registries play a key role in a modern economy, although they had previously taken such registries for granted).

24. De Soto Speech, *supra* note 10, at 17 ("[F]acts are man-made, and what

Recording creates a network of information supporting a network of transactions.[25] Property recording systems offer information to a number of constituencies, including: (1) owners, acting as sellers or as borrowers; (2) lenders, including mortgage providers; (3) other providers of capital; (4) buyers; (5) leaseholders; (6) title insurance companies; (7) governmental entities, such as police, regulators, and taxing authorities; and (8) other parties who may need to interact with the property at some time and know who the law deems to have ownership of the property.[26] Recording allows all of these market and legal participants to connect.[27] It is imperative that we recognize the variety of market players that use and benefit from the recording statutes and from the existence of reliable, verifiable

---

laws do, whether lawyers know it or not, is, make pictures of facts, and you make it in legal documents.").

25. According to de Soto:

> [P]roperty has got to be in a place where everything is standardised, it's got to be accountable, it's got to be functional, you've got to make it liquid, it's got a network, it's got to protect transactions, and it's got to be recorded. . . . [W]hat property does, is effectively it creates one of the world's most important information systems that have [sic] ever existed. You really know who owns what, and who has whose hand in whose pocket, and who has a claim and not, thanks to records.

Id. at 18.

26. Brescia provides a useful, partial description of some of these functions:

> Another important mechanism for protecting the rightful claims of lenders, borrowers, and third-parties is the manner through which each state requires anyone with an interest in property to notify appropriate authorities of that interest by recording evidence of that interest in a central, publicly accessible location or through some electronic, publicly searchable database. These property recording systems, typically administered at the local level, serve as central access points for anyone who may wish to purchase property to determine who claims an interest in the property he or she wishes to buy. Research at the local level will reveal the presence of property law claims so that one can purchase property with confidence that no one with a conflicting claim will come forward later to challenge the purchase because the seller of the property did not have the legal right to sell it.

Brescia, *supra* note 4, at 21-22 (footnotes omitted).

27. De Soto Speech, *supra* note 10, at 15 ("So property, basically, is a system that doesn't talk to us so much about the asset itself but how that asset connects. And things are very much [about] how things are connected. The trouble about connections . . . is that they're invisible.").

records of ownership.[28]

It is not just the owner and the most immediate lender that care about proper recording. Those who wish to invest in, contract with, lease from, or provide capital to property owners demand the existence of a recording system so that they can identify the ownership interests associated with the property, including determining whether and to what extent that property is encumbered by a mortgage.[29] So, too, do prospective buyers of property require a verifiable repository of title information to guide their purchasing decisions.[30] These other players must be able to discover the limits on title with a level of clarity.[31] Similarly, those who wish to provide loans secured by property or to make other capital investments in property need assurances that the owner owns the property that he says he owns and that the system reflects all competitive claims to or liens on title.[32]

While some efforts have been made to use technology to make recording systems more searchable and useful, there is still a great deal of modernization and innovation needed to update the recording system process[33] and to

---

28. SINGER, *supra* note 20, § 11.4.5.3 (describing chain-of-title problems).

29. Korngold, *Legal and Policy Choices*, *supra* note 3, at 739-40 (discussing the evolution of mortgages and recorded documents through the centuries). Korngold explains the evolution of recording acts in the United States and asserts that such acts were a milestone that "allowed buyers of interests in real property to trade in confidence and encouraged markets for sales and financing." *Id*.

30. *Id.*

31. De Soto Speech, *supra* note 10, at 18 ("Once you have taken property and the clarity that property is supposed to bring to human connections, you have brought havoc to the market, and that's what happened in sub-prime.").

32. Way, *supra* note 16, at 122. Way explains:

> Clear title also facilitates outside investments in property by allowing creditors to have faith in the property interest they are securing. When title interests are insecure or unclear, creditors will either refuse to invest in the property or, alternatively, devalue the asset to take into account the higher risk of the investment or the transactional costs of making the title interests more secure.

Id.; *see also* de Soto, *What If*, *supra* note 2 ("In the developing world, neither capital nor credit will venture where there are no clear property rights.").

33. Korngold, *Legal and Policy Choices*, *supra* note 3, at 740-41 (discussing the current property recording system as still paper based). Yet, Korngold notes that our system is improving with the growth of "technology to make the recording system more efficient, more transparent, and less costly" and cites the developments in electronic signatures law as one such example. *Id*.

increase compliance with it. Reform and modernization of recording processes could be beneficial (only a few of these reform measures will be discussed later in this article).[34] Some have called for greater standardization of recording as well.[35] As the next Part illustrates, both the structure of existing recording systems and attitudes toward recording need to change. Failures on both levels have only exacerbated the mortgage-foreclosure crisis.

When there are not clear records tracking the chain of title and the transfer of assignments in the mortgage and notes associated with the property, there are doubts about the legal authority to foreclose.[36] The system demands documentation of such authority to protect the property owners from unlawful or multiple demands on the property's title.[37] Unfortunately, recent foreclosure litigation and commentary on the foreclosure crisis have pushed aside or given limited attention to recording and other mortgage formalities.[38] Moreover, many of the foreclosure cases are concerned less about the availability of information regarding true ownership interests and instead focus on the issue of default.[39] Yet, if we had

34. For example, although it is beyond the scope of this article, Marsh makes a strong argument that the recording system is in need of improvement—particularly "finding" and "searching" mechanisms—and modernization should be a goal in any comprehensive approach to recording reform. Marsh, *supra* note 17, at 20.

35. *See, e.g.*, *id.* at 22 ("Beyond the archaic nature of the system, the dispersion of the recording function into thousands of local offices means that there is no standard system for recording and indexing. Recording laws differ from state to state, and indexing practices can differ over time in the same county."); *see also* de Soto Speech, *supra* note 10, at 5-6 (discussing the importance of standards using electricity flow as an example).

36. Brescia, *supra* note 4, at 19 ("These revelations raise doubts about whether these banks even have the right to foreclose on borrowers where such banks have difficulty proving that they are a party to the mortgages that underlie the foreclosure actions in question.").

37. *Id.* at 21 ("One of the most important of these [legal] protections is that in many jurisdictions a lender must maintain, in its possession, the original loan documents to prove that he or she has the right to foreclose on the property.").

38. Dana, *supra* note 7, at 506-07 (expressing dismay by the common dismissal of violations of "mortgage formalities" as insignificant in decisions on foreclosures especially in the face of clear debtor default).

39. De Soto notes:

> [W]hen you look at everything that has been called securitisation, it tells you whether documents are valid, it doesn't tell you whether it's the truth. So while formal property rights are statements about factual

insisted on strict adherence to procedure, recording, and other formal elements of the mortgage process, perhaps the crisis could have been averted; similarly, if we return to a stricter adherence to recording requirements and related rules then perhaps we can avoid a repeat of history.[40] Unfortunately, it took the mortgage-foreclosure crisis to expose some of the failures in recording that have emerged in the last couple of decades.[41]

III. BACKGROUND ON THE MORTGAGE MARKET, SECURITIZATION, MERS, AND THE CRISIS'S EFFECTS ON RECORDING

The mortgage market has changed substantially over time.[42] What we typically shorthand and call the "mortgage" process[43] includes a "note," in which the borrower promises to make payments on the loan, and a

---

> truths regarding such matters as who owns what and where that asset is located, the securitisation of property, from what I've been able to see, is essentially about validity, and that's a different item.

De Soto Speech, *supra* note 10, at 19.

40. Dana, *supra* note 7, at 508 ("[I]nsistence upon following [mortgage formalities]—as well as embracing more of them—might help prevent a repeat of the foreclosure crisis . . . .").

41. ARRUÑADA, *supra* note 23, at 229. Arruñada observes that when the financial crisis hit, "attentive observers started realizing that contractual registries play a key role in a modern economy," although these same people previously had largely taken such registries for granted. *Id.*

42. Dana, *supra* note 7, at 503. Dana provides the contrast between the past and present face of the mortgage market:

> In the "old days" of residential mortgage financing, the relevant players with respect to the secured credit on a home were simply "the bank" and "the borrower." The bank originated the mortgage, serviced it, and owned it. The bank rationally would agree to significant loan modification, even principal reduction, in order to avoid foreclosure where housing prices had dropped substantially since the origination of the mortgage. That has all changed. Now, with respect to the secured credit on a single home, there are a host of actors with an economic interest in whether, or how, the loan is paid back, modified, or both. Mortgages now are most often pooled and then serviced by an entity that holds no direct or indirect interest in the mortgage or mortgages in the pool.

Id. *See generally* Andra Ghent, America's Mortgage Laws in Historical Perspective (Jan. 20, 2013) (unpublished working paper, W.P. Carey Sch. of Bus., Ariz. State Univ.), *available at* http://ssrn.com/abstract=2166656 (providing a valuable survey of mortgage law and its development, including the basic structure of mortgages).

43. SINGER, *supra* note 20, § 11.5.

"mortgage," in which the borrower conveys an interest in the property in question to the lender. The mortgage allows the lending institution to act against the property, such as through foreclosure, if there is nonpayment on the loan.[44] During this process, the property owner promises to make payments on the mortgage to the loan-granting institution.[45]

In the traditional system of property law and recording, both an initial mortgage and any assignment had to be in writing (as transfers of interests in real property are subject to the Statute of Frauds) and recorded in the proper place, such as the county records office.[46] As the system became more complex, however, recording and certainty of title began to suffer.[47] In the 1990s, the mortgage system quickly became more complex and has since operated with increasing reliance on securitization.[48] With securitization, lenders make mortgage loans to the borrower and property owner, but the loans are then sold on a secondary market where they are resold once or several more times to securities investors, often bundled with other loans or even split up into different bundles.[49]

Securitization was motivated by a desire for profit. Under the traditional model where there is one lender/mortgagee and one borrower/mortgagor, the lender can make a substantial profit in the long term when the borrower eventually pays the loan back with interest.[50] But the initial capital outlay is substantial; the payoff from the loan takes time and patience, and funds that could be used

44. Dana, *supra* note 7, at 112 ("When one buys property with third-party financing, one invariably signs a mortgage and a note, both of which may create rights of recovery against the property in the event of default. Both mortgages and notes are assignable interests."); Alan M. White, *Losing the Paper—Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 471 (2012).

45. White, *supra* note 44, at 471.

46. *Id.* at 483-84.

47. ARRUÑADA, *supra* note 23, at 113-14 (discussing the progression of complexity in the mortgage market and how the market dealt with it, first by using title insurance to resolve risks and later, as securitization became more popular and complex, by turning to things like MERS).

48. Brescia, *supra* note 4, at 22-23 (describing securitization); White, *supra* note 44, at 471.

49. White, *supra* note 44, at 471.

50. Brescia, *supra* note 4, at 22-23.

to lend to even more individuals are tied up in the loan awaiting long-term returns.[51] Mortgage securitization in large part solves this liquidity problem. The lending institution makes the same loans but then sells the "future income stream" as a package immediately.[52] The proceeds from such sales are used to make more loans, which creates more "future income stream" products to be sold.[53] The purchasers of these "products"—the rights to receive payments on the loans and the expected profit generation attendant thereto—are typically other financial institutions who convert these products into entirely separate investment vehicles that they sell as multiple mortgages bundled together.[54]

Importantly, these securities further fragmented property interests among investors and between the securities offered.[55] Tranching, a complicated means of dividing securities into risk pools, has further divided property so that multiple investment interests have a stake in the payments on a property's mortgage and value.[56] The "securities" created and subject to exchange are backed by the mortgages and include the expected revenue generated from payments on the original loans.[57] As Dana explains, "By virtue of the financial alchemy of Wall Street, a single mortgage could be—and often has been—transformed into tens, hundreds, or even thousands of distinct investment interests."[58]

The market for these securities became very robust in the years before the crisis,[59] and a variety of other financial

51. *Id.* (discussing the "liquidity problem").

52. *Id.*

53. *Id.* at 23; Korngold, *Legal and Policy Choices*, *supra* note 3, at 729 ("[T]he mortgage brokers, mortgage companies, and local banks received a full return on their capital to lend again locally and also earned income on fees paid by each purchaser of the loan up the chain.").

54. Brescia, *supra* note 4, at 22-23.

55. Korngold, *Legal and Policy Choices*, *supra* note 3, at 729 ("The investment banks then issued securities, typically bonds, representing the right to receive certain payments under the mortgages, usually slicing the right to receive portions of the income and principal payments into various tranches.").

56. *See id.*

57. Brescia, *supra* note 4, at 22-23.

58. Dana, *supra* note 7, at 514.

59. Korngold, *Legal and Policy Choices*, *supra* note 3, at 729 ("The investors held or traded these mortgage-backed securities in an active market.").

innovations accompanied the rise in mortgage-backed securities, including the use of insurance-based credit-default swaps.[60] Many claim that, as securitization became more popular, the high demand from packagers of mortgages required lenders to make more initial mortgages in order to have enough products to sell to the packagers.[61] As the process built upon itself, it spiraled into a reduction in standards for loans that, at least in part, fueled the resulting mortgage-foreclosure crisis.[62] Therefore, many commentators attribute the mortgage-foreclosure crisis to the incentives generated by securitization.[63] Today, lenders originate loans, but very few of them continue to have any direct relationship with those loans, including payment, renegotiation, or other basics.[64] This means that the borrower must track and identify who has a present interest in the property and who is responsible for accepting payments and making decisions on such mortgages.

Fragmentation of property interests is not necessarily a bad thing. From a classic market-oriented or libertarian perspective, property owners should be able to slice and dice property at will into a variety of "sticks" or "interests," including third-party interests. The right of alienability allows persons to purchase these targeted, specialized interests in pieces of property. This right also allows separate and several interests in property to be transferred to a number of individuals with the price structure properly adjusted so individuals can purchase only the interests they need or desire in a property.

---

60. *Id.*

61. *Id.* at 730 ("As demand for mortgage-backed securities grew, and the bundles required more mortgages, investment banks and local banks lowered their underwriting standards for borrowers. . . . [T]he arrangement worked fine. Then came the mid-2000s when borrowers began defaulting on mortgage loans." (footnotes omitted)).

62. *Id.* at 730.

63. *See, e.g.*, Kurt Eggert, *The Great Collapse: How Securitization Caused the Subprime Meltdown*, 41 CONN. L. REV. 1257, 1257-68, 1297 (2009) (presenting a highly skeptical view of securitization as a financial strategy and attributing the cause of the subprime crisis to securitization and the incentive structures it created).

64. Kermit J. Lind, *Collateral Matters: Housing Code Compliance in the Mortgage Crisis*, 32 N. ILL. U. L. REV. 445, 447 (2012) ("The securitization of loans has changed the servicing of mortgages and unhinged the lenders' connection with the collateral. Very few lenders who originate loans keep them or collect payments on them." (footnote omitted)).

Nonetheless, while a liberal interpretation of a theory of property that embraces multiple rights and interests in any one thing of property as "sticks in a bundle" furthers alienability of the individual parts or sticks, such an interpretation decreases alienability of the whole because each person with an ownership interest in the property becomes an encumbrance on the sale of the whole.[65] One can only sell as much as he or she has. Thus, if some interests have been given away, anyone who purchases the property from the presumptive owner of the "whole" has the other ownership interests attached. Thus, in the end, the fragmentation of property into various ownership interests necessarily creates problems (the degree of the problem depends on the ability and cost to trace the ownership interests). These problems include high transaction costs in the transfer of property and a need to identify all of the ownership interests with certainty and stability before property can be transferred.[66] The existence of many "owners" of and within a piece of property due to the splitting of sticks or interests creates difficult issues of priority.

Thus, while theoretically the dissection of property into multiple interests should be favored, the practical concerns can be troubling. Serious questions concern whether the legal infrastructure in the United States is capable of handling the bundle concept taken to its extreme (with mortgage-backed securities as our best test case). At the very least, fragmentation of interests by securitization makes ownership interests in real property harder to identify, necessitating the existence of an accurate and complete means for tracking and recording these interests.

Although the benefits of securitization are largely beyond the scope of this article, it is an important financial mechanism for the efficient provision of capital and should not be sacrificed in an effort to resolve the mortgage crisis or to prevent future crises.[67] In fact, it is difficult to see the

65. *See* Dana, *supra* note 7, at 520.

66. *Id.* (discussing an anti-fragmentation undercurrent in some of property law).

67. *See* Steven L. Schwarcz, *Shadow Banking, Financial Markets, and the Real Estate Sector* 3 (World Econ. Forum, Working Paper No. 2157605, 2012)

provision of loans in today's financial system without some reliance on securitization.[68]

To make securitization effective, the loan-granting institution typically assigns its rights in both the note and the mortgage, sometimes to different parties.[69] Due to transfers to the secondary market, securitization, and multiple assignments of notes and mortgages, it can become difficult to trace all of the steps along the way.[70] This flurry of activity—and the number and variety of participants involved[71]—can lead to problems in the chain of title and identifying who currently holds the enforceable note and mortgage interests against the property owner.[72] These problems are especially evident when the formalities of transfer, such as required endorsements of notes, are not satisfied and when the transfers are not recorded in some central repository. "Central repository," as used in this article, means some identifiable, agreed upon, and authoritative location where records are collected and need not necessarily mean a national system. As they currently stand, local county records offices fit the definition of "central repository" for purposes of this article's discussion of the idea.

To avoid the rigor of recording, lenders and their assignees in the securitization process used a variety of techniques that they substituted for traditional recording to

---

(forthcoming B.U. REV. BANKING & FIN. L.), *available at* http://ssrn.com/abstract=2157605 ("Securitization is important both to the housing recovery and to commercial real estate generally, because it is a critical means of enabling mortgage-loan originators to regain liquidity to make new loans . . . . A common political response to the recent financial crisis, however, has been to restrict securitization." (footnote omitted)).

68. *Id.*; Korngold, *Legal and Policy Choices*, *supra* note 3, at 732 (describing securitization as a "beneficial mechanism" that should be preserved).

69. White, *supra* note 44, at 471.

70. *See id.* at 499 (noting that "wide gaps appeared in the chains of loan ownership" as a result of the sloppy means of transferring and assigning notes and mortgages).

71. Dana, *supra* note 7, at 513 ("The number and variety of investors in pools of first mortgages can make identifying who has a stake in any given mortgage quite challenging."); Schwarcz, *Understanding*, *supra* note 5, at 565 ("[O]ne of the reasons market participants have had difficulty learning the financial condition of their counterparties is that so many firms entered into over-the-counter credit derivatives under which they bought or sold risk.").

72. *See* White, *supra* note 44, at 472 (discussing the problem in the context of foreclosure sales).

protect their own interests.[73] Many saw the hurdles of recording and simply ignored the process altogether which made it difficult for lenders and their assignees to prove their ownership interests, leading to further delays and uncertainties when foreclosure became necessary.[74] Others used a method that involved blank mortgage assignment forms.[75] The originator of the mortgage prepared a form to be filled in at the time of foreclosure with the necessary names of the interest holders at the time of foreclosure so they could establish standing to foreclose.[76] Of course, this was just one way that lenders viewed recordation as existing only for their own benefit, without recognizing the broader societal interests in tracking the assignments.

Lenders and their assignees in the securitization process also employed MERS as another alternative to traditional recording.[77] MERS has been the subject of substantial commentary in post-crisis literature.[78] It was

---

73. Arruñada explains how the markets took the recording system for granted and lost sight of its necessity as they became frustrated with the difficulties of operating within it:

> Analysts and policymakers have taken [registries] for granted, focusing their attention instead on newer welfare-state interventions . . . . Their disregard for the institutional foundations of markets goes a long way toward explaining why most of the US registries that I have analyzed in this book are stunted, shaky institutions whose functions are partly provided by private palliatives. In land, the public county record offices have been unable to keep up with market demands for speed and uniform legal assurance. Palliative solutions such as title insurance duplicate costs only to provide incomplete *in personam* guarantees or even multiply costs, as Mortgage Electronic Registry Systems (MERS) did by being unable to safely and comprehensively record mortgage loan assignments.

ARRUÑADA, *supra* note 23, at 229.

74. White, *supra* note 44, at 485 ("A third probably unplanned method was to take neither step, so that when foreclosure becomes necessary, the servicer is forced to obtain an assignment (or perhaps fabricate one) from the original lender to the current owner.").

75. *See id.*

76. *Id.*

77. *See* Marsh, *supra* note 17, at 20, 22-23 (discussing the emergence of MERS).

78. *Id.* at 23 ("MERS has been a controversial innovation."). For discussions on MERS, see generally Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359 (2010); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111 (2011)

created in 1993 and was designed to electronically process and track mortgage ownership, including any assignments or other transfers.[79] MERS was supposed to solve some problems associated with the high transaction costs of recording and ease the speed with which mortgage-backed securities and related notes were transferred by serving as an intermediary recording institution.[80]

Under the MERS approach, an original mortgage or any initial assignment using MERS is first recorded in the appropriate public records office where MERS is named as the lender's nominee or proxy mortgagee of record.[81] Any subsequent transfer or assignment of beneficial interests in the property is recorded and tracked inside the MERS database, which is, theoretically, transparent and accessible to the public.[82] If MERS functioned effectively,[83] any subsequent transfer or assignment of the mortgage would be identifiable by simply examining MERS's internal records.[84] In theory, the MERS option makes sense in terms of reducing transaction costs and otherwise adapting to the securitization process in an efficient manner while also maintaining a repository of information resembling traditional record systems.[85] However, in practice, MERS has not operated as theorized or modeled.

MERS has been a central player in the mortgage industry in recent years. As Peterson reports in a 2011 article, the majority of "the nation's residential mortgages are recorded in the name of MERS Inc., rather than the bank, trust, or company that actually has a meaningful

---

[hereinafter Peterson, *Two Faces*].

79. Korngold, *Legal and Policy Choices*, *supra* note 3, at 741-42.

80. *Id*. at 742.

81. Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352, 367-75 (D. Mass. 2011), *aff'd*, ___ F.3d ___, 2013 WL 563374 (1st Cir. Feb. 15, 2013) (discussing the operational aspects of MERS); Korngold, *Legal and Policy Choices*, *supra* note 3, at 741-42; White, *supra* note 44, at 485, 499.

82. *Culhane*, 826 F. Supp. 2d at 367-75; Korngold, *Legal and Policy Choices*, *supra* note 3, at 741-42; White, *supra* note 44, at 499.

83. ARRUÑADA, *supra* note 23, at 74-75, 113-14 (describing MERS and how it was intended to work).

84. *See* White, *supra* note 44, at 485.

85. ARRUÑADA, *supra* note 23, at 2-6 (discussing the general benefits of registries including decreasing transaction costs, facilitating private exchange with confidence, and incentivizing investment).

economic interest in the repayment of the debt."[86] As a consequence, Peterson continues, "[f]or the first time in the nation's history, there is no longer an authoritative, public record of who owns land in each county."[87] The lack of record alone seems concerning, but if MERS was an adequate substitute for county records offices, then the displacement would not be a substantial problem. The trouble is that MERS has not served as an adequate substitute.

While the concept behind MERS to overcome transaction cost problems associated with traditional recording procedures is appealing, operationally MERS has not demonstrated a high degree of confidence in its comprehensiveness or reliability in tracking interests in title. Therefore, it has not provided the level of certainty desired and required in a well-functioning market. MERS, and the industry's reliance on MERS to successfully circumnavigate the traditional methods of title recording, contributed to the mortgage-foreclosure crisis through its failure to perform as modeled.[88]

One of the major problems with MERS is that it is dependent on its members—lending institutions and banks—to input the information necessary to keep the records accurate and current. Reliance on voluntary content providers led one court to describe MERS as "the Wikipedia of land registration systems."[89] As such, many commentators contend that MERS has generally lacked reliability.[90]

Furthermore, because lenders abandoned traditional recording in favor of MERS, they are now facing foreclosure problems that might have been avoided:

---

86. Peterson, *Two Faces*, *supra* note 78, at 117.

87. *Id.*

88. ARRUÑADA, *supra* note 23, at 114 ("The 2010 crisis was at least partly caused by bad incentives and poor performance by MERS and the mortgage industry's members, as well as their apparent oblivion of the judicial and political risks ever remaining on the enforcement of home foreclosures against apparently 'weak' parties." (footnote omitted)).

89. Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352, 368 (D. Mass. 2011).

90. *See, e.g.*, White, *supra* note 44, at 486 ("Because MERS relied on its mortgage industry members—banks and servicing companies—to voluntarily report loan ownership transfers, the MERS database was not a reliable record of those transfers.").

> The residential foreclosure crisis has brought MERS's flaws into clearer view. The inherent opaqueness of MERS has apparently hidden from public view some rather shoddy recordkeeping practices on the part of the lenders. In the fall of 2010, several major residential lenders implemented self-imposed foreclosure moratoriums due to systemic problems in proving ownership of the relevant mortgages. *If lenders had complied with the public land title system, a string of mortgage assignments would have easily allowed them to establish standing to file a foreclosure action.*[91]

The problems with MERS have further complicated foreclosure proceedings throughout the nation,[92] and litigation against MERS has been widespread.[93]

Studies show that there are substantial gaps in the information available through MERS, leading to greater uncertainty of title.[94] For example, there are serious problems if a company sues to foreclose and its authority to do so is only known by MERS; in this situation, title cannot be discovered in the recording office and searching MERS's databases is problematic. MERS simply has not lived up to the concept's potential and cannot claim to be a comprehensive, nationwide system that provides certainty of title information by tracking all interests in any particular piece of property.[95] To serve as an adequate public records system (and as a substitute for what historically has existed in county records offices), the information in MERS would need to be accessible on a broad public scale, in addition to

---

91. Marsh, *supra* note 17, at 24 (emphasis added) (footnote omitted); *see also* Davidson & Dyal-Chand, *supra* note 8, at 1635-36 (discussing how some courts have begun to resort once again to land registries to identify ownership, thus ignoring MERS's claims to "ownership").

92. *Culhane*, 826 F. Supp. 2d at 360 ("Nationwide, courts are grappling with challenges to MERS's power to assign mortgages as well as its practice of deputizing employees of other companies to make assignments on its behalf.").

93. Martin C. Bryce, Jr. et al., Challenging Progress: County Recorder Lawsuits Against MERS, 1946 PLI /CORP 455 (2012); White, *supra* note 44, at 487-93 (discussing waves of MERS litigation).

94. White, *supra* note 44, at 486 (identifying substantial information deficiencies within the MERS databases).

95. *Id.* at 487 ("[O]ur results are consistent with those from other investigators: MERS is not a nationwide database that tracks changes in . . . ownership interest in mortgage loans." (internal quotation marks omitted)).

being comprehensive and current.

Yet another criticism lodged against MERS has been its lack of transparency. As Marsh explains, "Initially, only paid customers of MERS were able to access the information it stores. . . . MERS has recently created a system, called MERS Servicer Identification System, which is designed to permit homeowners to discover the identity of their servicer and the investor that owns their loan," but problems still persist.[96] Moreover, it is not enough for records to be available to the homeowner, the lender, and relevant assignees. Public records must be made available to all who may benefit from or require the information in public land records to properly and effectively conduct their business, including providing capital to property owners.

Another major flaw in MERS is that it fails to properly track both the mortgage and the note. The note and mortgage may be separated in the complex securitization process, meaning the information regarding all parties with any interest in the property is incomplete.[97] To be effective, MERS and similar systems must find some means of tracking both instruments through all assignments and transfers, even when the recording of notes may not have been required under traditional property recording rules.[98] The issue of notes being subject to separate, and perhaps less stringent, recordation expectations creates even more confusion.[99]

---

96. Marsh, *supra* note 17, at 23 (footnote omitted).

97. Dennis Montali, Cecily A. Dumas & Ron M. Oliner, *Recent Developments in Business Bankruptcy—2011*, 32 CAL. BANKR. J. 147, 186-87 (2012) (discussing Cervantes v. Countrywide Home Loans, Inc., 656 F.3d 1034 (9th Cir. 2011)). The article examines the problems associated with splitting the mortgage from the note and how MERS does not properly account for and track the split. *Id*.

98. White, *supra* note 44, at 498 (discussing the problems that arise when notes and mortgages travel separate assignment paths and when there are mixed recording requirements or expectations).

99. Robert Hockett explains the uncertainty in who owns what when the mortgage and the note are separated:

> There appears to be considerable uncertainty within and across states concerning who may enforce mortgage-secured promissory notes against whom, and accordingly gain title to the mortgage deeds, hence the collateral, securing those notes. There is also confusion concerning whether mortgage deeds might be severed from the notes they secure in the event that note-assignments are not accompanied by change-of-

Finally, if a MERS-type system is designed or maintained improperly or incompletely and the market begins to rely on it instead of traditional recording, there is a substantial risk of a loss of certainty and transparency, as this quasi-public system would hold a monopoly on available information. Some courts and commentators have recognized these risks, and any efforts to find a suitable replacement for MERS should take these concerns into account.[100]

MERS is well-intentioned, and it has some of the attributes of an effective replacement for the traditional recording system with adaptations to modern technology and the modern needs of financial instrument innovations. The central repository aspects of MERS allow for efficient, easy, and low-cost transfers.[101] The trick lies in creating

---

> lienholder recordings in local property registries. Both sets of confusions appear to have played some role in prompting the fabrication of false *ex post* paper trails of the sort that have figured into recent "robo-signing" scandals. Both also, of course, occasion transaction costs . . . .

Robert C. Hockett, *Six Years On and Still Counting: Sifting Through the Mortgage Mess* 32 (Cornell Legal Studies Research Paper No. 12-11, 2012), *available at* http://ssrn.com/abstract=2029262.

100. Consider the following from Judge Kaye of the New York Court of Appeals:

> The lack of disclosure may create substantial difficulty when a homeowner wishes to negotiate the terms of his or her mortgage or enforce a legal right against the mortgagee and is unable to learn the mortgagee's identity. Public records will no longer contain this information as, if it achieves the success it envisions, the MERS system will render the public record useless by masking beneficial ownership of mortgages and eliminating records of assignments altogether. Not only will this information deficit detract from the amount of public data accessible for research and monitoring of industry trends, but it may also function, perhaps unintentionally, to insulate a noteholder from liability, mask lender error and hide predatory lending practices.

MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 88 (N.Y. 2006) (Kaye, C.J., dissenting in part).

101. Korngold makes the following claim:

> MERS facilitates an efficient secondary market in mortgages by allowing the easy transfer of beneficial rights. After the initial recording in the local clerk's office, subsequent transactions can be done quickly at a low cost from a central location utilizing modern technology without the need for local recording of paper assignment documents. Such a process facilitates the flow of global capital, bringing investment funds into areas without local mortgage financing.

something like MERS that accomplishes these financial goals while also facilitating the goals of certainty and knowledge that come from a truly comprehensive and reliable recording system.

During the mortgage crisis, there was a breakdown in the certainty of title because securitization led to assignments of mortgages and notes that were not always properly recorded. As such, the true ownership interests were difficult to trace. This generated a number of problems because when the recording of a mortgage is incomplete, it is unclear who homeowners owe. Therefore, homeowners cannot track their payments,[102] have confidence that their payoff is complete, find the correct entity to provide assurance of complete payoff,[103] or identify the right party with whom to renegotiate terms or seek modification.[104]

> Potential homeowners, as well as those seeking the most favorable rates, can benefit from MERS.
>
> Unfortunately, some judicial decisions during the recent spike in subprime and conventional foreclosures have questioned MERS.

Korngold, *Legal and Policy Choices*, *supra* note 3, at 742 (footnotes omitted); *see also MERSCORP*, 861 N.E.2d at 88 ("The benefits of the system to MERS members are not insubstantial. Through use of MERS as nominee, lenders are relieved of the costs of recording each mortgage assignment with the County Clerk . . . . Transfers of mortgage instruments are faster . . . .").

102. White, *supra* note 44, at 494-95. White explains:

> The endorsement and delivery of a tangible paper note, the reification of a payment obligation, serves to protect borrowers from paying an obligation twice, or paying the wrong creditor. . . .
>
> In any such case, the borrower wants to be sure that the servicer delivers all payments they make to the proper party. After full payment, borrowers should not face demands for more money, or worse yet, foreclosure actions on the paid-off debt. Any electronic system for tracking ownership rights in mortgage loans must be sufficiently reliable and authoritative so that consumer borrowers are protected from double liability.

Id. (footnotes omitted).

103. *Id.* at 495. White first explains the motivation: "Borrowers who complete their mortgage loan payments not only wish to avoid further liability, but also are entitled to have the mortgage lien removed from the property records to clear their title and permit future sales, or mortgages." *Id.* White then explains the obstacle: "While an accurate and authoritative database of mortgage ownership would in theory solve the problem, the extensive inaccuracy of MERS seems to only compound the difficulty." *Id.*

104. *Id.* at 496 ("One of the many complaints from homeowners and their advocates about mortgage servicers during the 2007-2012 foreclosure crisis has been

Particularly troublesome is the inability to identify with certainty the responsible interest holders in property. This failure has impeded the ability to modify and renegotiate home loans, an especially troubling difficulty when so many homeowners desire a modification to avoid foreclosure. If the law required greater attention and care to mortgage formalities, these obstacles to loan modifications would decrease.[105]

When homeowners wish to renegotiate their mortgage loans, because they are unable to make payments and face foreclosure, it is necessary for homeowners to be able to identify with whom to renegotiate terms of a loan modification.[106] Property owners must know who has the legal authority to make such modifications, especially because that entity may not be the servicer of the mortgage.[107] To do so, property owners must be able to track, identify, and find that entity with authority. Property owners must also have a sense of certainty and confidence that they have found the correct entity. The transaction and information costs are high when there is no reliable recording system providing that information.[108] These high transaction costs could be avoided with more reliable tracking and if information was made available through proper systems like recording.[109]

As a result of inadequate recording of titles and associated assignments, lenders have faced difficulties

---

the difficulty in negotiating loan modifications and other alternatives to foreclosure.").

105. Dana, *supra* note 7, at 508.

106. Korngold, *Legal and Policy Choices*, *supra* note 3, at 746 ("[W]here there are multiple owners of an interest, it may be unclear who has the authority to modify the instrument and arrive at a workout of a troubled loan with the borrower.").

107. *Id.* ("Even if the servicing agreement empowers the servicer to do workouts, servicers may refuse to do so out of fear that beneficial owners of the mortgage may second-guess the modification decision and attempt to hold the servicer liable for deviating from the initial note.").

108. Hockett, *supra* note 99, at 19, 34 (explaining the inefficiencies that result when borrowers have difficulties "determining who bears ultimate authority to renegotiate loan terms with them"). Hockett calls for further empirical research to identify the scope of the problem. *Id*. at 19 n.33.

109. *Id.* at 34 (discussing how confusion, including over who to negotiate with and who has standing, creates high and avoidable transaction costs). This confusion "give[s] rise to uncertainties that can adversely affect the present values of RMBS and residential real estate." *Id.*

proving ownership of the mortgages they need to foreclose.[110] Noncompliance with recording formalities, the limitations of the current recording requirements, and the inadequacy of MERS's recordkeeping all contributed to these debt collection obstacles.[111] With poor records, lenders have difficulty establishing the necessary "standing" to foreclose,[112] where the court requires that "the foreclosing party has identified and obtained, by assignment or otherwise, the mortgage and/or note for the property that is the subject of the foreclosure."[113] Furthermore, standing typically requires, if formalities were followed, that the party seeking to foreclose hold both the mortgage and the note, as the foreclosure action resolves disputes regarding both instruments by extinguishing both if foreclosure is successful.[114]

Issues arising from noncompliance with mortgage "formalities" have just begun to be litigated.[115] But questions of certainty of title as a result of the sloppy methods used during the years immediately preceding the crisis can substantially delay foreclosures.[116] Some courts have begun to question the validity of foreclosures when there are defects in the chain of title at issue—even when the validity of the claim and/or the existence of default are

---

110. Marsh, *supra* note 17, at 19 (discussing the existence of such difficulties in a number of recent foreclosure cases).

111. De Soto explains the essence of this record collection problem:

> Banks that have tried to foreclose on non-performing mortgages have discovered that in many cases they can't collect the debts. Why? Because some companies that pooled, packaged, and converted those mortgages into liquid securities had dispensed with the usual procedures to record mortgage owners and passed the property to a shell company called MERS, which pretended to own the mortgages. The intent was to streamline what many real estate experts recognize are outdated, disaggregated, and cumbersome processes.

De Soto, *Destruction*, *supra* note 6, at 61-62.

112. Marsh, *supra* note 17, at 23 n.19.

113. Dana, *supra* note 7, at 510.

114. *Id.* at 512-13.

115. *Id.* at 510 ("[R]elatively few judicial opinions have addressed the issue of mortgage formalities and the consequences of noncompliance.").

116. White, *supra* note 44, at 493 ("[T]he most likely ongoing impact, and the impact observed to date, has been and will be that homeowners intervening before a foreclosure judgment and sale, especially in judicial states, can prevent or delay foreclosure for extended periods of time, and in significant numbers.").

otherwise unquestioned.[117]

At the same time, information should be available prior to any foreclosure proceedings, especially in states where there is a limited ability for homeowners to challenge foreclosure sales ex ante. Post-sale invalidations based on invalid chains of title are difficult to obtain: "most courts have been unwilling to permit former homeowners to challenge a foreclosure sale after the fact based on mortgage transfer problems, whether the homeowners seek equitable relief undoing the sale or money damages."[118]

For the most part, the mortgage industry has been, and still is, operating without a modern means of recording that fits the modern demands of speed, accuracy, comprehensiveness, and reliability.[119] The attempted innovations have been positive, but they have been operated poorly or have been under-utilized.[120] The incredible volume of transfers in mortgages hampered the ability of the mortgage industry to effectively use traditional, paper recording methods, yet there was not a very good substitute.[121] In the end, this meant in many cases that documents were not recorded or were recorded incompletely.

These defects and the resulting uncertainty that blurs

---

117. *See, e.g.*, *id.* at 491; *see also* U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 52-53 (Mass. 2011).

118. White, *supra* note 44, at 492.

119. *Id.* at 470 ("[T]he law and practice of electronic transfers of the largest individual credit obligations, home mortgage loans, have not yet converged.").

120. *Id.* at 470-71 (describing the emergence of MERS and the Federal E-Sign statute). White laments, though, that "the Federal E-Sign statute, providing for electronic Note negotiation, as well as the Uniform Real Property Electronic Recording Act, have lain dormant and largely unused." *Id.* (footnote omitted).

121. Brescia, *supra* note 4, at 25 (discussing "the sheer volume of mortgages they needed to process and the speed with which those mortgages changed hands"). Brescia explains that, as a result of the quantity of mortgages, "in the securitization process, not all transactions were properly documented and recorded, and bank personnel often failed to secure and maintain original documents throughout the course of these transactions." *Id.* (footnote omitted); *accord* Marsh, *supra* note 17, at 19 ("When the antiquated local title recording system failed to meet the needs of national lenders, they created a separate, private, limited access system to record and track residential mortgage assignments."); White, *supra* note 44, at 471 ("As the volume of mortgage transfers and foreclosures exploded, the mortgage industry was either unwilling or unable to follow the old paper-based rules, but it had no effective alternative to support the dematerialization of mortgage loan sales.").

the title have caused title instability,[122] and they have made foreclosure litigation difficult in all jurisdictions. One cannot escape these defects; they arise as direct challenges prior to foreclosure or as post-sale challenges. The courts are still wrangling over how to deal with these defects effectively. In the meantime, the uncertainty has caused delays and even prevented some foreclosures that might have otherwise been valid.[123] White explains, "Massive origination of mortgage loans relying on the sell-to-distribute model, followed by massive foreclosures, has led to chaos in the legal processes to track who may foreclose and sell homes."[124]

So the financial crisis revealed the crisis in recording, but the problems with recording are not limited to foreclosures and the current mortgage mess. One of the functions of a recording system is to provide information to all parties potentially interested in dealing with any one piece of property.[125] Some problems have not been discussed much in the literature on the mortgage crisis generally or even in the recording-specific discussions on the problems with securitization. These problems require introduction and brief exploration.

Too often the law and literature on the mortgage-foreclosure crisis concern only owners, lenders, and holders of securities. However, recording flaws affect the entire economy, including potential acquirers of property and others that wish to transact with the property beyond mere lenders in the mortgage market. While we are currently focused on problems with foreclosure actions, incomplete recording and uncertainty of title also affect the security of solvent transfers of property.

The inability to track ownership interests or discover the identity of the mortgage servicer for property

122. Mark Ellis, *Legal Profession Must Shape Our Post-Crisis Future*, INT'L B. NEWS, Oct. 2010, at 7, 7 (discussing the blurring of legal title that occurred during the period immediately preceding the mortgage crisis).

123. White, *supra* note 44, at 483 ("At this stage, it is simply too soon to predict the extent of title litigation and foreclosure delays that will result from note transfer failures.").

124. *Id.* at 499.

125. Marsh, *supra* note 17, at 20 (describing the goals of the recording system, particularly the provision of notice to the public, including to prospective buyers).

complicates matters for third parties with concerns about the condition of the property. These third parties, such as the police or local regulators, often have a difficult time identifying the rightful and responsible owner of property causing community harm or violating local codes.[126] Additionally, taxing authorities have had difficulty clearly identifying ownership interests to know who to tax.[127] The provision of disaster relief is yet another example of a difficulty that has arisen due to lack of clear title.[128]

In addition, capital investments are impeded when records are incomplete. The defects in title create barriers to capital with severe economic consequences.[129] The provision of other loans on the property besides mortgages is adversely affected when there are uncertainties in the chain of title.[130] Moreover, the leasing market is disrupted

---

126. Consider Lind's description of this problem:

> Borrowers typically do not encounter anyone associated with their residential mortgage who is concerned about the condition of the collateral. . . . Municipal officials charged with policing neighborhood and residential housing conditions go to great lengths to engage mortgagees and their servicers in communication about the condition of houses that are safety hazards or that have been condemned for demolition. With few exceptions, mortgage servicers do not respond to notices, warnings, or other communication, indicating that the collateral securing payment owed them is being wasted or has become a threat to the value of other collateralized housing in the neighborhood securing loan payments.

Lind, *supra* note 64, at 448-49 (footnote omitted).

127. De Soto, *Destruction*, *supra* note 6, at 62 ("Already the lack of facts is being felt around the U.S.: Courts from Kansas to New York have decided that foreclosures have been improper, and some authorities can't figure out whom to tax."). De Soto adds, "Without facts, credit will continue to be scarce, the value of bonds backed by mortgages will be at best doubtful, the value of houses is likely to slide further, foreclosure backlogs should increase, and banks will see their balance sheets burdened by more nonperforming paper." *Id.*

128. Way, *supra* note 16, at 118 (explaining how the provision of relief during disasters can be complicated when one cannot prove title).

129. Brescia, *supra* note 4, at 22 n.18. Brescia explains that working through the defects in title from the pre-crisis behaviors "will inevitably raise transaction costs associated with proving title to land so that owners can use such property to secure capital and, should they wish, alienate it freely." *Id.* He proceeds to explain that "[s]uch a process can hamper economic development considerably. As Hernando de Soto argues, a functioning system of property titling is often what distinguishes functioning and dynamic economies from ones that are stagnant." *Id.*

130. Korngold, *Resolving*, *supra* note 18, at 1564 ("This system [of recording] has served to create an active and safe American real estate market by providing security of titles and realty interests, enabling the efficient use of land as collateral

because persons are less willing to lease property for fear that an existing foreclosure action could disrupt their possession. The mere risk could cause a person to refrain from entering into a leasehold agreement or to enter into it based on less than ideal and efficient price terms to discount for the risk.

The title insurance industry is another under-explored area affected by the imperfect recording practices exercised before the mortgage crisis. Undoubtedly, title-search costs increase when the records are sloppy or inaccurate. Similarly, the risks that title insurance companies must bear in the face of uncertainties will likely raise the price of title insurance and will likely price some property owners out of the market for title insurance altogether.

In sum, as securitization became common practice and the housing boom blurred priorities, market participants found every way to avoid using recording systems unless absolutely necessary and, as such, lost out on the full advantages available within those systems.[131] Markets need information, and secondary markets have tended to make title information less accessible and transfers less transparent.[132] Many participants exhibited short-term thinking and were unwilling to make the small, initial investments necessary to solidify the long-term security and verifiability of their holdings.

This shortsightedness was evident in the market players' creation of what could have been a very efficient solution to recording difficulties—MERS. This private warehouse of public memory, if kept current and if policed with standards, would have worked well to overcome the high transaction costs associated with the regular recording of the transfer or assignment of mortgage notes. The problem is, in part, that MERS was done on the cheap. Again, the participants sacrificed long-term confidence for short-term gain. First, it became a "Wikipedia of land registration systems" instead of a system with a reliable

for loans, and allowing prospective buyers to locate owners and bargain with them over potential deals.").

131. De Soto Speech, *supra* note 10, at 18 (noting that those involved in securitization did not respect the elements of recording).

132. Korngold, *Legal and Policy Choices*, *supra* note 3, at 743-44.

third-party manager.[133] MERS has had minimal enforcement. Enforcement can occur within private systems in a variety of ways. Non-compliant firms can be expelled from the system, or compliant firms can receive seals of approval, certification, or other badges of honor that would add to their market credibility. But MERS did not employ a full set of incentive structures to exert quality control over the information in its databases. MERS faced transparency problems, has not been easily searchable, has not been universally accessible, and was not well organized.[134] It also failed to take full advantage of the technology available that could have allowed a system like MERS to modernize and revolutionize the recording system in positive and efficient ways. Meanwhile, regulators also dropped the ball on recording and failed to recognize how closely tied the success of a property market is to a system of verifiability.

Without a central repository of recorded interests in property, we lose the benefits of transparency and notice that recording should provide to those who wish to interact with the property, to those who must be able to investigate and discover the owners associated with it, and to those who wish to protect their current interest in the property.[135] The more difficult it is to identify ownership interests, the harder it is to transfer the property as a whole. The harder it is to trace ownership interests—calculated by the level of transaction costs associated with a sale or the verifiability of ownership in any court dispute—the less stable the real property market becomes. The next Part further explains the connection between recording systems and market realities.

133. Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352, 368 (D. Mass. 2011), *aff'd*, ___ F.3d ___, 2013 WL 563374 (1st Cir. Feb. 15, 2013).

134. *See* Bain v. Metro. Mortg. Grp., Inc., 285 P.3d 34, 40-41 (Wash. 2012) (en banc).

135. De Soto Speech, *supra* note 10, at 18 (explaining that we do not know who owns what without clear records).

IV. RECORDING, CERTAINTY OF TITLE, THE FUNCTIONING OF MARKETS, AND THE ROLE OF THE STATE

This Part seeks to review what was lost when recording formalities were set aside in the mortgage market. It returns to some of the fundamentals of why we have recording and how it fits within the functions of government and the effectiveness of markets. This Part also explores the role of government in providing title assurance mechanisms like recording in order to provide the foundations upon which a market is built. This Part looks in greater detail at the characteristics of an effective recording system and lays the groundwork for recording reform.

As de Soto explains, recording or registry systems serve as "public memory systems" providing the basic information that markets need to identify ownership, describing:

> [T]he invention of the first massive "public memory systems" to record and classify—in rule-bound, certified, and publicly accessible registries, titles, balance sheets, and statements of account—all the relevant knowledge available, whether intangible (stocks, commercial paper, deeds, ledgers, contracts, patents, companies, and promissory notes), or tangible (land, buildings, boats, machines, etc.). Knowing who owned and owed, and fixing that information in public records, made it possible for investors to infer value, take risks, and track results. The final product was a revolutionary form of knowledge [known as] "economic facts."[136]

De Soto contends that these key "economic facts" are destroyed and the strength of the recording and registration systems suffer when memory systems are ignored.[137]

---

136. De Soto, *Destruction*, *supra* note 6, at 60.

137. De Soto posits:

> Over the past 20 years, Americans and Europeans have quietly gone about destroying these facts. The very systems that could have provided markets and governments with the means to understand the global financial crisis—and to prevent another one—are being eroded. Governments have allowed shadow markets to develop and reach a size

Although de Soto speaks of a broad problem in housing and ownership more generally,[138] de Soto's analysis is still applicable to this article. The failure to adhere to recording rules in the United States resembles the shadow markets in third-world economies that also have unrecorded interests in property.[139] In the immediate pre-crisis days, "securities had slipped outside the recorded memory systems and were no longer easy to connect to the assets from which they had originally been derived."[140]

Where recording systems do not exist for property rights, sophisticated and developed markets cannot operate efficiently. Conversely, where there is a high level of verifiability, comprehensive recording, and neutral enforcement, the system operates well.[141] With the securitization of mortgages and the fragmentation of ownership interests in property in the United States, much uncertainty exists in our current ownership structures.

De Soto is well known for his work documenting and explaining the functioning of informal economies in the third world. He demonstrates the need for formality, including recording systems, to provide an environment conducive to the movement of property in commerce, the extension of credit, and the acquisition of capital.[142] In many informal economies in the developing world, people have claims of ownership of property, but they have no way to prove it. Thus, the property owners in these societies— or "informals" as de Soto calls them— lack any protection

---

> beyond comprehension. Mortgages have been granted and recorded with such inattention that homeowners and banks often don't know and can't prove who owns their homes. In a few short decades the West undercut 150 years of legal reforms that made the global economy possible.

Id.

138. *See generally* de Soto, *Destruction*, *supra* note 6.

139. *Id.* at 60-61 (comparing the shadow markets of informal economies to the shadow markets that may result in the United States due to unrecorded interests in property partly as a result of securitization).

140. *Id*. at 61.

141. Ellis, *supra* note 122, at 7 ("As Hernando de Soto laid out so brilliantly in his unforgettable speech at the IBA Annual Conference in Buenos Aires in 2008, clarity of legal title has been the foundation of all modern economic growth.").

142. *See, e.g.*, DE SOTO, MYSTERY, *supra* note 11, at 47 ("Any asset whose economic and social aspects are not fixed in a formal property system is extremely hard to move in the market.").

from those who seek to take their property—whether it involves attacks on ownership from other members of the public or from the government.[143] These property owners cannot establish the validity of their ownership claims where there is no authoritative or enforceable record for such a claim.[144] Because they are unable to prove ownership and because there is no security of ownership or predictability of future maintenance of private control over the property, lenders are unwilling to extend credit to informals or accept their property as collateral.[145] Property in these informal systems does not have status that allows for this additional value or utility.[146]

This conundrum is what de Soto describes as the mystery of, or more precisely the impediment to, the accumulation of capital in informal economies.[147] Until these systems develop formal mechanisms of property ownership recognition, they cannot prosper from the benefits of efficiently functioning capital markets.[148] As

143. DE SOTO, OTHER PATH, *supra* note 11, at 56-57 ("[T]he [informal property] system is unstable because it does not protect the informals when others try to invade their land [because they lack proof of verifiable ownership]. The absence of a legal system of efficient property rights is detrimental to all.").

144. *Id.* at 161-62 ("The absence of public registers of the property rights of informals makes it even more difficult to establish the validity of a claim. . . . [T]here are valid disputes over ownership and no register in which to research their history.").

145. *Id.* at 162 ("[T]he same reasons inhibit the use of property as collateral, one of the various benefits traditionally conferred on property owners."). De Soto explains that this is because lenders must spend large amounts of time and money investigating and verifying that the person claiming to own the property offered as collateral does indeed own it. *Id.*

146. Hernando de Soto, *Why Capitalism Works in the West but Not Elsewhere*, INT'L HERALD TRIB., Jan. 5, 2001 [hereinafter de Soto, *Why Capitalism Works*], *available at* www.cato.org/publications/commentary/why-capitalism-works-west-not-elsewhere ("To be useful in an expanded market, capital must first be represented in a property document where it can then be assigned a status that allows it to produce additional value. What most people possess outside the West is not 'paperized' in such a way as to produce capital.").

147. *See, e.g.*, DE SOTO, MYSTERY, *supra* note 11, at 49-51 (describing the flow of capital from formalization processes).

148. De Soto reaches the following conclusions:

> Assets outside the West are held in defective forms: houses built on land whose ownership rights are not adequately recorded, unincorporated businesses with undefined liability, industries located where financiers and investors cannot see them. Because the rights to these possessions are not adequately documented, these assets cannot

developing nations transform themselves into market economies, they must establish some form of registration or recordation of property that creates formality.[149] These lessons from third-world economies serve as a warning of the possible broader economic consequences that could result from the failure to address the certainty deficits in the existing financing schemes and recording structures in the United States.

Certainty of ownership is necessary to facilitate private market-based transactions. People will not acquire or invest in property or extend credit to property owners[150] in an efficient manner and on optimal terms if they have a low level of certainty in the claimed owner's rights to the property.[151] Whenever one market participant wishes to exchange rights with another, such as in the acquisition of property, the transferee demands confidence that the transferor has the authority to transfer the property—the relevant and required ownership interest. The level of certainty that the transferee has in the transferor's authority to convey the interest is directly proportional to the level of investment the transferee will be willing to make to complete the deal.[152] For example, if one is certain

---

> readily be turned into capital, cannot be traded outside of narrow local circles where people know and trust each other, cannot be used as collateral for a loan and cannot be used as a share against an investment.

De Soto, *Why Capitalism Works*, *supra* note 146.

149. Thomas J. Miceli et al., *The Dynamic Effects of Land Title Systems*, 47 J. URB. ECON. 370, 370 (2000) ("One of the least controversial principles in the economics of land markets is the notion that the more clearly defined the property rights, the greater the land market efficiency.") Further, "registration may be the preferred choice for developing countries that are in transition to market economies and private property systems." *Id*. at 387.

150. Brescia, *supra* note 4, at 21 ("Once property is used as collateral to secure loans, there is a heightened risk that conflicting claims will arise over the right to title of the property.").

151. De Soto Speech, *supra* note 10, at 16 ("[G]lobally . . . the problem is that nobody's going to invest unless they know who owns it, or that they own it. Nobody's going to remove the rocks; nobody's going to put in the irrigation systems or the roads, until they feel they own it.").

152. Singer explains that:

> This system [of recording] helps clarify the state of the title and provides buyers with assurances that the person purporting to sell them land actually owns it and that the land is not subject to any competing claims or encumbrances that might conflict with their ability to obtain

that the would-be transferor does not have ownership of the property in question, the would-be transferee will be unwilling to pay anything for the property because, if there is no security of ownership in the transfer, the transferee is in essence acquiring nothing. Here, the risk of losing the property to another party making a claim to it after acquisition is high and, therefore, the price is zero.

If the would-be transferee has 100% certainty that the transferor has full authority and absolute ownership in the property, then the transferee will presumably pay full fair market value for the property. The transferee knows that he is acquiring the highest level of superior rights and need not worry about a subsequent claimant to the property (assuming that the transferee is also certain that his superior rights will be enforced).[153]

Whenever a potential transfer takes place somewhere between these two extremes, which is more often the case in the real world, then there is some level of uncertainty involved in the transaction. Whether the transfer is completed will depend on a number of variables, including the relative willingness of the transferee to assume risks.[154] At the highest levels of uncertainty—low confidence in the authority of the transferor—a transferee may determine that the risks are too high because the property may become the subject of contested ownership from some third party. This may be true even if there is no knowledge of a competing claimant to the property but instead results from the absence of any reliable system for the acquirer ex ante (or a judge ex post) to confidently determine what constitutes certain ownership.[155] The closer one gets to the other end of the spectrum where there is a high level of certainty and confidence in the transferee regarding

---

title or use the property as they wish.

SINGER, *supra* note 20, § 11.4.5.1.

153. De Soto Speech, *supra* note 10, at 14 ("[I]t's the law that represents you in documents. It's through law and legal documents that you're able to identify facts, that you're able to identify risks.").

154. *Id.* at 15 ("[P]roperty has more to do with general connections than it has to do with the asset itself.").

155. SINGER, *supra* note 20, § 11.4.5.1 ("[Recording is] essential both to provide an official record of the state of the title and to protect the buyer against any competing claims that may be created by the grantor in others.").

whether the transferor actually owns what he offers to sell, then the deal is more likely to be completed.[156] As the level of uncertainty increases, transactions are either not completed, even when perhaps it would have been otherwise economically beneficial to complete the transaction, or the price of the property involved in the transaction is discounted by the amount of risk associated with the lack of full, provable, certain information of ownership.

Similarly, individuals will not invest in their own property in an efficient manner if they do not have certainty of ownership and they are not confident that they will be able to reap the gains of their investment. Private property rights provide an incentive to invest in property precisely because individuals have some guarantee that they will be entitled to the fruits of that investment. Thus, confidence and certainty in ownership are essential for the efficient use of property.

In each of the investment or acquisition scenarios discussed above, one's level of certainty is necessarily affected by: (1) the existence of some neutral, third-party system of verifiability (e.g., a repository of information like a recording system) that serves as an authoritative measure of ownership for both market participants and the state enforcers of those rights;[157] (2) the existence of and confidence in a neutral state enforcement system to adjudicate ownership disputes; and (3) an ability to confidently and accurately predict how the neutral enforcement system will adjudicate disputes so that one can evaluate whether and on what terms to make the initial investment or acquisition based on the rule of law.[158]

---

156. Way, *supra* note 16, at 122 ("Property laws that produce clear title interests make it easier to move property in the market in several ways. They allow the market to determine who owns what interests in an asset and thus facilitate free trade of the asset on the open market." (footnotes omitted)).

157. ARRUÑADA, *supra* note 23, at 4 ("[T]hese protections in fact eliminate the information disadvantage suffered by third parties and thus reduce transaction costs, making trade easier.").

158. De Soto, *Destruction*, *supra* note 6, at 63 ("The rule of law is much more than a dull body of norms: It is a huge, thriving information and management system that filters and processes local data until it is transformed into facts organized in a way that allows us to infer if they hang together and make sense.").

What then should the state's role be in providing this high level of certainty? One of the primary ways that the government can provide certainty to market participants in the undisturbed ownership of assets is to provide a high level of confidence that the government will respect that ownership, will not confiscate property once acquired or investments once made, and will not otherwise disrupt or interfere with the sanctity or enforceability of property exchange.[159] If the government uses its coercive and confiscatory powers to undo transactions made between private parties, those parties will discount the price they pay for goods or property and diminish the investments they are willing to make because continued ownership is uncertain. Therefore, investment is decreased and prices do not reflect actual value. Consequently, the market cannot operate efficiently, and property cannot be exploited for its best uses or channeled to its most productive purposes.

The first role of the government in promoting certainty is to minimize its capacity to disrupt market transactions. With constitutional limits or self-restraint, the government can add certainty into the marketplace for property and other goods if the market has confidence that interference will be kept to a minimum. The second way that the government can help foster certainty in the market for property (or for other private-market transactions) is to provide a neutral system for the resolution of private disputes and the enforcement of agreements according to the original terms of the transacting parties and consistent with their rights. The courts and other governmental systems play a necessary enforcement function in private markets, without which markets could not effectively operate. As Epstein explained, the Lockean world is necessary to deal with the Hobbesean man.[160] These

159. Way, *supra* note 16, at 121 ("American property laws supporting clear title and more formal landholdings have historically promoted two key values: security and alienability. Security in ownership—the principle that an owner's property rights cannot be taken away, except by the government with just compensation—is a fundamental attribute of American property ownership." (footnote omitted)).

160. RICHARD ALLEN EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 9-10 (1985) ("Locke searched for the *tertium quid*,

enforcement mechanisms, coupled with the common-law doctrines of property, contract, and tort law which define rights and reciprocal responsibilities, are integral parts of a free-market system with private property and freedom of contract lying outside and apart from the transactions. Thus, these neutral government actions are to be distinguished from the governmental actions that are interferences *inside* the marketplace. The former foster certainty, while the latter hinder it.

When it comes to the courts and the systems of neutral enforcement, the rule of law must exist within these minimally necessary institutions.[161] There must be objectivity and neutrality in the resolution of disputes such that the judgments of the adjudicating parties are sufficiently predictable ex ante. So long as parties engaging in a transaction can predict the resolution of possible disputes, they can transact in a manner that avoids litigation. This can be accomplished by price adjustments to reflect risk or assignments of risk or liabilities. Accordingly, these minimally necessary governmental structures operate best when their mere existence leads to efficiency and order in the private market, in part because of the ability of the parties to a transaction to predict the results of the adjudication of any controversy that might arise.[162]

Next, the recognition and protection of property rights and the development of rules furthering alienability promote economic growth.[163] Private property rights

---

that is, for a set of institutional arrangements that would allow individuals to escape the uncertainty and risks of social disorder without having to surrender to the sovereign the full complement of individual rights.").

161. Todd J. Zywicki, *The Rule of Law, Freedom, and Prosperity*, 10 SUPREME CT. ECON. REV. 1, 22 (2003) ("The documented effect of increasing rule of law values on economic growth is robust. Individuals are more willing to invest in economic growth where property rights are stable, contracts are secure, and arbitrary governmental action is restrained.").

162. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 26-27 (1962) (explaining that so long as the system is structured correctly, the markets benefit from, but need not use, the legal system as an enforcement mechansism).

163. *See* Way, *supra* note 16, at 121 ("American laws supporting the alienability of property—the ability to freely sell property for market value or to otherwise transfer property—have evolved as a means to promote the economic development of property and support a free market economy."); *see also* FRIEDMAN, *supra* note 162, at 27 ("[T]he existence of a well specified and generally

encourage investment in production, and the ability to identify such rights motivates investments and encourages exchange.[164]

Finally, governments can help foster a climate of certainty in property and other transactions by providing a "market-facilitating" means of verifying ownership to which parties can turn before making acquisition and investment decisions. The papering of property rights, in the words of de Soto, "allows the whole economy to move."[165]

One might think that those in favor of free markets would hesitate to support "requirements" to record ownership in a state-based system to get the full benefits of the state-provided means of neutral enforcement. This next discussion focuses on that concern and explains that such systems of recording ownership claims are not antithetical to free markets. Registration or recording of property interests is necessary to the effective functioning of efficient markets. The facilitation of verification of title should be seen as a necessary component of even the most limited governments. Recording systems and registries of property rights are enablers of progress, and the market depends on certainty and information.[166]

The protection of property fits into the essential functions of government and is of fundamental constitutional concern.[167] John Locke argued, "The great and *chief end*, therefore, of men's uniting into commonwealths, and putting themselves under government, *is the*

---

accepted definition of property is far more important than just what the definition is.").

164. DE SOTO, OTHER PATH, *supra* note 11, at 162 ("The difficulty of transferring an asset always reduces the incentive to invest further in it . . . .").

165. De Soto Speech, *supra* note 10, at 16 ("But while we can see the physical thing, we can't see the relational thing, and the relational thing is strictly something that you can see in law, and it's in a property paper. That is what allows the whole economy to move.").

166. De Soto, *What If*, *supra* note 2 ("Legally created titles and stock certificates generate investment; clear property records guarantee credit; documents allow people to be identified and helped; company statutes can pool resources for recovery; mortgages raise money; contracts solidify commitments.").

167. For a discussion of the role that the protection of property rights has played in United States history, see generally Douglas W. Kmiec, *The Coherence of the Natural Law of Property*, 26 VAL. U. L. REV. 367 (1991).

preservation of their property. To which in the state of nature there are many things wanting."[168] Property recording systems are vital to such preservation. In the absence of recording or registration systems for property, market participants like those in nations with informal economies are still competing on the level of a state of nature without any Lockean means for the preservation of property.

Similarly, James Madison explained the state's role regarding property when positing that, "Government is instituted to protect property of every sort . . . . This being the end of government, that alone is a *just* government, which *impartially* secures to every man, whatever is his *own*."[169] We cannot secure to every person what is their own if there is not a clear mechanism to identify what they own and provide some measure of *authoritative* ownership so that parties can govern their own private relations and the government can intervene when necessary to objectively resolve disputes.[170] Again, recording provides authority and certainty in the creation, preservation, cultivation, maintenance, stewardship, and improvement of such a system and should be accepted as a role of the government.[171]

---

168. JOHN LOCKE, SECOND TREATISE OF GOVERNMENT 66 (C.B. Macpherson ed., Hackett Pub. Co., 1980) (1690). Locke describes the importance of liberty underlying the protection of property:

> *[F]reedom of men under government* is, to have a standing rule to live by, common to every one of that society, and made by the legislative power erected in it; a liberty to follow my own will in all things, where the rule prescribes not; and not to be subject to the inconstant, uncertain, unknown, arbitrary will of another man . . . .
>
> This *freedom* from absolute, arbitrary power, is so necessary to, and closely joined with a man's preservation, that he cannot part with it, but by what forfeits his preservation and life together . . . .

Id. at 17.

169. James Madison, *Property*, NAT'L GAZETTE, Mar. 27, 1792, *reprinted in* 14 THE PAPERS OF JAMES MADISON 266 (Robert A. Rutland et al. eds., 1983).

170. *See* FRIEDMAN, *supra* note 162, at 25 ("In both games and society also, no set of rules can prevail unless most participants most of the time conform to them without external sanctions . . . .").

171. *Id.* ("These then are the basic roles of government in a free society: to provide a means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules on the part of those few who would otherwise not play the game.").

Market advocates (not just businessmen but those officials who support free markets) often lose sight of the benefits of recording or are reluctant to embrace robust public recording systems or requirements because it is government "involvement" in the marketplace. That is true. But these free-market advocates have an incomplete understanding of the proper role of government in a market-based society. As Arruñada explains:

> Behind these weaknesses in public registries lies a misunderstanding about the role of registries in the economy and the proper role of the state in providing services for the registration of private contracts. For markets to function, it is often thought that a minimal state is good. This confuses the liberal-state institutions *supporting* markets with the welfare-state institutions *replacing* markets. Registries are conceived as unnecessary barriers instead of as facilitators of transactions. Such disregard for registries' value and their organizational complexity leads to policies that, by minimizing public registries, give way to the overgrowth of industries providing ineffective palliative services, such as those of lawyers, notaries, title insurers, or financial dealers.[172]

Recording systems are precisely the type of market facilitators that fit within the minimum governmental role anticipated by liberalism and necessary to the effective functioning of free markets.[173] Just as one would not strip away the role of the courts to adjudicate contract disputes because contracts would be far less meaningful without a neutral, credible, third-party arbiter with some coercive enforcement powers,[174] so too we should not reflexively

---

172. ARRUÑADA, *supra* note 23, at 230.

173. Audrey G. McFarlane, *The Properties of Instability: Markets, Predation, Racialized Geography, and Property Law*, 2011 WIS. L. REV. 855, 885 ("Recording acts reflect an unquestioned principle that a market-based property system must contain a market-smoothing mechanism.").

174. *See* FRIEDMAN, *supra* note 162, at 25. Friedman explains:

> And just as a good game requires acceptance by the players both of the rules and of the umpire to interpret and enforce them, so a good society requires that its members agree on the general conditions that will govern relations among them, on some means of arbitrating different interpretations of these conditions, and on some device for enforcing compliance with the generally accepted rules.

reject a government program like property recordation that provides the type of evidence necessary for neutral, third-party judges to determine, with some level of predictability, who maintains ownership.[175] All of this should be ever more evident in the face of the mortgage-foreclosure crisis that has exposed the holes in the market structure left unplugged by an incomplete recording system and related control mechanisms.[176]

Economist and well-renowned free-market advocate Milton Friedman explains that some minimal, market-facilitating roles exist for government:

> The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rules of the game" and as an umpire to interpret and enforce the rules decided on. What the market does is to reduce greatly the range of issues that must be decided through political means, and thereby to minimize the extent to which government need participate directly in the game.[177]

Recordation requirements fit within this rubric by creating the rules of the game for proving and recognizing ownership. David Hume similarly posited that, "It is only a general sense of common interest; which sense all the members of the society express to one another, and which

---

Id.

175. *Id.* at 27, 34 (summarizing the primary role of government to ensure certain minimum protections including enforcing and interpreting contracts and property rights).

176. Davidson & Dyal-Chand, *supra* note 8, at 1608-09. The opportunity to learn the lessons of history and adjust our property systems and the vision of the state's role are explained well by Davidson and Dyal-Chand:

> Property law and the larger discourse of property are forged not only in the steady accretion of economic and social development, but also in moments of dramatic change. Repeatedly throughout American history, times of crisis have brought to the fore fundamental questions about the nature of property, the state's role in this aspect of private ordering, and the balance between the individual and the community.

Id. at 1608.

177. FRIEDMAN, *supra* note 162, at 15; *see* de Soto, *Why Capitalism Works*, *supra* note 146 ("[T]he great practitioners of capitalism were able to reveal and extract capital by devising new ways to represent the invisible potential locked up in the assets we accumulate.").

induces them to regulate their conduct by certain rules."[178]

De Soto makes a related defense of "public memory" systems within a free market and declares them necessary components in an otherwise laissez-faire governance system:

> Markets were never intended to be anarchic: It has always been government's role to police standards, weights and measures, and records, and not condone legalized sleight of hand in the shadows of the informal economy. To understand and repair one of mankind's greatest achievements—the creation of economic facts through public memory—is the stuff of nation-builders.[179]

Delineation of ownership facilitates exchange. Contracting would be impossible if parties were unable to trade rights. Likewise, property ownership must be protected from aggression in order for a civil society to flourish.[180] At a minimum, therefore, government must have the power to protect these institutions of property and free exchange,[181] and part of that power includes basic structural market facilitators, such as recording.

Systems providing for or requiring recording of interests in private property with some state authority serve as repositories of valuable and necessary market information.[182] They are databases of public knowledge.[183] With these systems, market participants can have a higher degree of confidence and certainty in what they own, what they have the authority to transfer, and what other parties own and have the authority to transfer. Through these verifiability systems, market participants and judges have equal access to a reliable, recognized, and accepted source

178. DAVID HUME, A TREATISE OF HUMAN NATURE 314-15 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2000) (1740).

179. De Soto, *Destruction*, *supra* note 6, at 63.

180. *See* LOCKE, *supra* note 168, at 72.

181. *See id.*

182. SINGER, *supra* note 20, § 11.4.5 (discussing the basics of recording systems and registries of deeds).

183. De Soto Speech, *supra* note 10, at 18 ("What you've lost is your capacity to connect, because you've lost the track that property gives you [when the recording system is non-existent or failing]. So the problem is essentially one of epistemology, of knowledge.").

of definitive information. As such, market participants are able to look at the same records as courts. So long as they also know the means of interpretation those courts will employ, market participants will be able to predict how the neutral arbiters will resolve their differences because society has agreed on authoritative status for these records.

V. REFORM EFFORTS

It is clear that we must embrace the government's role in recording systems and must develop a recording system that provides certainty.[184] The current recording laws simply are incapable of handling the complexity of securitization.[185] Any reform requires that we realize that the recording failures lie at the heart of the mortgage-foreclosure crisis.[186] One must necessarily look to basic principles of property law to find the moorings of the crisis.[187] An exact blueprint for such a system of reforms is largely beyond the scope of this article.

By focusing solely on the financial aspects of the crisis, many reform efforts risk losing sight of private property law, failing to address the fundamental cracks in the architecture of those laws, and undervaluing the formal elements of ownership necessary for a well-functioning market economy. Reforms focused solely on the financial incentives involved in mortgages or securitization or on remedying exploitative tactics will not be effective if the fundamental formal structure at the base of the system

184. ARRUÑADA, *supra* note 23, at 230 ("To overcome the collective action problem in the creation of both organized exchanges and contractual registries, more effective public interventions are necessary.").

185. Davidson & Dyal-Chand, *supra* note 8, at 1656 ("[F]oreclosure laws and processes are no longer in sync with the complex balance of ownership generated by securitization."); Marsh, *supra* note 17, at 19 ("[A]nother opaque system that has failed to keep pace with the increasing complexity of the modern real estate industry [is the] the American land title system.").

186. De Soto, *Destruction*, *supra* note 6, at 63 ("If we can agree that the recession wasn't about bubbles but about the organization of knowledge, we can move on to restoring the systems that allowed the global economy to expand more in the last 60 years than in the previous 2,000.").

187. Davidson & Dyal-Chand, *supra* note 8, at 1610 ("Because the current economic crisis started in the housing market and because the response has sparked primal concerns about how the government is reshaping the nature of ownership, it is a crisis even more deeply grounded in and evocative of property.").

remains severely flawed. While many see some role for governmental action through regulatory intervention,[188] any reform efforts must take into account and preserve the financial mechanisms and devices that are necessary for the efficient functioning of modern markets.[189]

The cases decided to date on securitized mortgages reveal differing views on whether certain mortgage assignments and notes must be recorded. If the goal is to incentivize recording, recording must be required, or, alternatively, non-recorded instruments must not be recognized. If there are no negative consequences, lenders and others will continue to ignore recording, because there is no identifiable disadvantage. If courts begin insisting on formalities, financial institutions will be encouraged to adopt a higher standard of care. By creating a climate that demands more diligence and responsibility in the provision of mortgages, financial institutions will change their behavior.[190]

Reformers should focus on the faults in the recording system and develop strategies to create a well-functioning and comprehensive system of tracking ownership interests in property, including mortgages and notes. It is clear that we must find some way, at least for dealing with future mortgage-based issues, to require mortgage and note transfers to be recorded and tracked by some effective electronic means.[191] Notes and mortgages could be required to be imaged and recorded together, for example.[192]

---

188. *See, e.g.*, Schwarcz, *Understanding*, *supra* note 5, at 560 ("It may well be helpful to have a central governmental agency with a mandate to protect against financial crises of any type, including financial instability.").

189. Korngold, *Legal and Policy Choices*, *supra* note 3, at 732 ("Care must be taken to correct the abuses but not to choke the functioning of the markets. Furthermore, some solutions must be left to the markets themselves.").

190. *See* Dana, *supra* note 7, at 519-20 ("In the least, the courts may encourage more thoughtful mechanisms for use in securitization, including better PSAs, and more investments in maintaining a reliable system of mortgage and note registration and their assignments.").

191. White, *supra* note 44, at 499-500 ("A transition from paper to electronic note/mortgage transfers could solve many problems going forward, but it will not clear the foreclosure backlog, nor will it clarify the muddied titles that are one of the legacies of the 2007 crisis.").

192. *Id.* at 498. ("The first and most obvious step in moving to a reliable and authoritative electronic system protecting lenders, borrowers, assignees and other

A variety of reforms related to recording have been proposed. Some have called for a "fully generalized MERS[-type] system."[193] Given that the concept of MERS is attractive, movement toward such a model, with the bugs and defects addressed, is a good starting point. Some other recent proposals call for improving technology or moving toward federalization of land records.[194] Again, there are many good points to be made regarding modernizing with technology and moving toward standardization. But, we must remember that many of the failures seen in the mortgage-foreclosure crisis resulted from the incomplete use of such technology and recording, along with documentation, recording, and tracking requirements that were too narrow in scope.

The recording system has been the subject of reform proposals for decades and not solely as a result of the problems exposed by the recent crisis.[195] Yet, sometimes it takes a crisis to make reform a reality.[196] Perhaps that will

---

parties to property title is to combine the note and mortgage into a single instrument, with the full image of the instrument and all later modifications to its parties and terms updated in a single electronic registry. Such a system would promptly eliminate the issues created when the note and mortgage travel on different paths, or appear to do so.").

193. Hockett, *supra* note 99, at 41. Hockett explains his thoughts on such a proposal for an effective MERS-modeled system:

> Insofar as modifications are now being impeded by Borrowers' uncertainty concerning who is authorized to negotiate modifications with them, various measures could be helpful. . . .
>
> Another measure would be reform of the current mortgage and note recording system, ideally in the form of a readily accessible and -editable electronic registry system—e.g., a fully generalized MERS system. Were such a system to include constant real time information concerning who is authorized to negotiate modifications on behalf of noteholders, there might be no need of further legislation on this particular score. The Federal Government, moreover, could support implementation of some such system at less political risk than would like attend support of a particular piece of pending legislation.

Id. at 40-41.

194. Marsh, *supra* note 17, at 20 (proposing use of technology and possible federalization as ways to improve the recording system).

195. *See, e.g.*, Marsh, *supra* note 17, at 20, 24-26 (discussing past proposals to modernize the land recording system and proposing a new and modern recording system combined with prohibiting MERS registration).

196. Davidson & Dyal-Chand, *supra* note 8, at 1609 ("The deepest social and cultural fault lines around property inexorably rise to the surface in moments of crisis and leave their mark on the texture of property law.").

be the case with recording after the mortgage-foreclosure crisis in order to better protect our property system in the future.[197]

There are some goals for which any reform for a real property and mortgage/note recording system should aim. It must have characteristics of transparency, accuracy, completeness, and authoritativeness.[198] The system must have effective measures for updating and keeping records current. There must be incentivized compliance and effective policing of any recording requirements. These and other similar characteristics must exist if the system is to provide a high level of certainty of title.

VI. CONCLUSION

If we understand that one can transfer only as much property as one has, we should equally understand that such a rule is only useful if we have the means to figure out what one has in the first place. Reform measures will only be meaningful if they create a system in which property owners can determine in an authoritative, certain way their property interests and how those interests will be enforced. Clear rights and predictable enforcement mechanisms allow people to adjust their behavior and arrange their interactions around that knowledge. These truths lie at the heart of the importance of certainty of title and at the core of the justification for the existence of market-facilitating registries or recording systems documenting property ownership.

---

197. Korngold, *Resolving*, *supra* note 18, at 1530 ("Citizens, courts, and legislators of our current generation need to consider the future generations as stakeholders among the usual constituencies as we continue the evolutionary shaping of our doctrines and system of land transactions.").

198. White makes such a suggestion:

> To deal with contract renegotiations, possible double payment issues and prompt satisfaction issues, a better system design would incorporate transparent and authoritative registration of mortgage loan ownership throughout the life of the loan, and not just at the point foreclosure is initiated. Obviously, a system relying on electronic document images, or on a database, would need adequate safeguards to insure accuracy and to justify its use as an authoritative determinant of mortgage loan ownership.

White, *supra* note 44, at 497.

The purposes of this article have included highlighting the failures in recording following the securitization trend and amplified by the mortgage-foreclosure crisis; using the occasion to illuminate the values of certainty of title to the proper functioning of a property system and the related economic markets that such a system serves; underscoring the basic and essential purposes of recording in providing such certainty; and defending the role of the government in providing the market-facilitating mechanism of a recording system. Consequent to that discussion, it should be clear that we must embrace that governmental role and develop a recording system that serves the values of certainty discussed in this article.

The mortgage-foreclosure crisis has given us a unique case study in what happens when we lose sight of the importance of recording. It also gives us an occasion to discuss again the importance of verification and title assurance regimes and perhaps also introduces a renewed sense of urgency to reform our recordation system, requirements, and related rules. This article has attempted to explain the functioning of recording systems and to provide some of the background justifications for reform. Innovators should develop a system with these lessons in mind regarding the importance of certainty of title. While this article stops short of making any specific proposals, any new and modernized recording system or mortgage loan ownership registration system must be transparent, accurate, complete, and authoritative, with effective measures for updating and keeping records current.