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**Mortgage Banking &
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Life on MERS: Mapping the Landscape

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Introduction

Over the past several years there have been increasing attacks by anti-home foreclosure advocates on the role played by the Mortgage Electronic Registration System (“MERS”) in the residential mortgage market. As we discussed in an earlier client alert, a substantial body of case law had developed confirming the validity of MERS’s role as nominee of the lender and any assignee on a mortgage or deed of trust.¹

Recently, a few courts have issued decisions that have led commentators to suggest that the direction of judicial opinions recognizing the validity of the so called “MERS system” may be reversing course. This is not, however, the first time the mortgage lending and servicing community has heard such suggestions. While some would portray these recent decisions as raising concerns with the role MERS plays in the lending industry and foreclosure process, these decisions are generally limited in scope, are dependent upon state-specific law, or simply offer non-binding judicial commentary. Although a few courts may identify perceived deficiencies with the use of MERS in certain contexts, the majority of courts presented with questions regarding the validity of the MERS system continue to accept and uphold MERS’s role as a legitimate cog in the mortgage lending industry.

Cases in the Headlines

In the last few weeks, decisions from the state courts in New York and Michigan and federal courts in Oregon have garnered much attention in the media. Upon closer examination, however, these decisions may not be quite as earth-shattering as first reported.

On June 7, 2011, the Appellate Division of the New York Supreme Court issued a decision in *Bank of New York v. Silverberg*,² in which the court considered whether MERS had the right to assign a “consolidation agreement” that purported to merge a first and second position note and mortgage into a single obligation.³ In that case, the

¹ *Loan Holders are from Venus and Plaintiffs are from MERS*, Mortgage Banking & Consumer Financial Products Alert, by R. Bruce Allensworth, Brian M. Forbes, Gregory N. Blase, October 15, 2010, available at <http://www.klgates.com/newsstand/Detail.aspx?publication=6709>. MERS serves “to streamline the mortgage process by using electronic commerce to eliminate paper.” See also <http://www.mersinc.org/about/index.aspx>. To facilitate this process, MERS acts as a nominee of mortgage lenders and their assignees. *Id.* MERS’s status as nominee for the mortgagee remains fixed while the servicing rights on a mortgage loan are assigned and transferred. *Id.*

² --- N.Y.S.2d ----, 2011 WL 2279723 (N.Y. App. Div. Jun. 7, 2011). The Appellate Division is the intermediary appellate court of the New York State Unified Court System.

³ *Silverberg*, slip op. at 1-2.

Life on MERS: Mapping the Landscape

borrowers were obligated on first and second position notes to Countrywide Home Loans, Inc. MERS was identified as the lender's nominee on both mortgages. The "consolidation agreement" stated that MERS was acting as the lender's nominee for the purpose of recording the consolidation agreement. Notably, Countywide, the originator of both loans, was not a party to the consolidation agreement. Later MERS recorded a document that purported to assign the consolidation agreement. Under this peculiar set of facts, the appellate court considered "whether a party has standing to commence a foreclosure action when that party's assignor – in this case, ... MERS[] – was limited in the underlying mortgage instruments as a nominee and mortgagee for the purpose of recording, but was never the actual holder or assignee of the underlying notes."⁴ The appellate court reversed the decision of the Supreme Court (the trial court in New York), which had denied the defendant borrowers' motion to dismiss the plaintiff's foreclosure action, because the "consolidation agreement" "did not give MERS title to the note, nor [did] the record show that the note was physically delivered to MERS."⁵ The court reasoned that although the loan agreements "gave MERS the right to assign the mortgages themselves, it did not specifically give MERS the right to assign the underlying notes, and the assignment of the notes was thus beyond MERS's authority as nominee or agent of the lender."⁶ Absent from the record before the appellate court was any evidence that the trustee for the securitization trust (the foreclosing plaintiff) was the noteholder, either by physical possession of the note or otherwise.

In *Residential Funding Co., LLC v. Saurman*,⁷ the Michigan Court of Appeals resolved a pair of consolidated cases that addressed "whether MERS is an entity that qualifies under [the Michigan non-judicial foreclosure statute] to foreclose by advertisement . . . , or if it must instead seek to foreclose by judicial process."⁸ Under the relevant Michigan statute, only three classes of entities are authorized to foreclose by advertisement: an owner of the debt, an owner of an interest in the debt, and a servicing agent.⁹ As MERS did not contend it owned the debt or was a servicing agent, the question before the court was whether MERS owned an interest in the debt. Reasoning that "in order for a party to own an interest in the indebtedness, it must have a legal share, title, or right in the note," the court concluded MERS did not own any such interest because "MERS, as mortgagee, only held an interest in the *property* as security for the note, not an interest in the note itself."¹⁰ As a result, the court held that MERS was not authorized under the Michigan statute to initiate foreclosure-by-advertisement and voided the two foreclosure sales at

⁴ *Id.*

⁵ *Id.* at 8.

⁶ *Id.* at 7. Nevertheless, the court did reject the borrowers' theory that the foreclosing entity was required "to provide *proof of recording* of the . . . assignment of the mortgage prior to the commencement of the [foreclosure] action" in order to establish ownership of the note, because "an assignment of a note and mortgage need not be in writing and can be effectuated by physical delivery." *Id.*

⁷ --- N.W.2d ---, 2011 WL 1516819 (Mich. Ct. App. Apr. 21, 2011).

⁸ *Saurman*, slip op. at 1. The other case in the consolidated appeal was styled *Bank of New York Trust Co. v. Messner*, Appeal No. 291443.

⁹ *Saurman*, slip op. at 4; see Mich. Comp. Laws § 600.3204(1)(d).

¹⁰ *Saurman*, slip op. at 5 (emphasis in original).

Life on MERS: Mapping the Landscape

issue.¹¹ The court also rejected the argument that MERS could serve as the agent for the owner of the debt or the owner of an interest in the debt, because the statute specifies certain agents – namely, servicing agents – that are authorized to foreclose by advertisement.¹² Notably, the court did not address whether MERS, as nominee on a security instrument, may *assign* a mortgage or deed of trust to the noteholder prior to the institution of non-judicial foreclosure proceedings.

The impact of the Michigan Court of Appeals’ decision in *Saurman* is already being felt. A recently-filed class action in federal court in Detroit seeks to capitalize on the *Saurman* decision by challenging non-judicial foreclosures in Michigan undertaken in the name of MERS.

In Oregon, a series of recent decisions have added to the confusion regarding MERS’s role in assigning residential deeds of trust. For example, in *Hooker v. Northwest Trustee Services, Inc.*,¹³ the borrowers challenged the foreclosure of their property under the Oregon Trust Deed Act, arguing that the defendants failed to properly record assignments of the deed of trust and appointments of successor trustees prior to recording the notice of default required by the non-judicial foreclosure statute.¹⁴ The only assignment recorded prior to the institution of foreclosure proceedings was by MERS as nominee. The court noted that “the Oregon Trust Deed Act requires the recording of *all* assignments by the beneficiary.”¹⁵ The court reasoned that the MERS MIN Summary contemplated several “intermediary” assignments (i.e. from originator to depositor, and from depositor to trustee). Based on this observation, the court concluded that the defendants had failed to record each assignment of the deed of trust, which, according to the court, violated the state’s non-judicial foreclosure statute.¹⁶

It should be noted that much of the *Hooker* court’s apparent criticism of MERS is dicta (non-binding commentary), as the judge himself recognized.¹⁷ Indeed, the *Hooker* court acknowledges that the mere fact that “MERS was the agent or nominee of the beneficiary does not mean the non-judicial foreclosure proceedings necessarily violated Oregon law.”¹⁸ It should also be noted that *Hooker* did not directly involve allegations regarding MERS’s legitimacy, but was instead a case about the validity of assignments in general.

¹¹ *Id.* at 11. As a result of the *Saurman* ruling, and in order to ensure good and marketable title, it has been reported that the U.S. Department of Housing and Urban Development is now requiring re-foreclosures on Michigan real-estate owned properties in which MERS had foreclosed by advertisement under Michigan’s non-judicial foreclosure statute. See Austin Kilgore, *HUD to Redo Michigan MERS Foreclosures*, AMERICAN BANKER, May 31, 2011, available at http://www.americanbanker.com/issues/176_103/hud-to-redo-michigan-mers-foreclosures-1038176-1.html.

¹² *Saurman*, slip op. at 7-8.

¹³ Civ. No. 10-3111-PA, 2011 U.S. Dist. LEXIS 57005 (D. Or. May 25, 2011).

¹⁴ *Id.* at *2-3.

¹⁵ *Id.* at *9 (emphasis added).

¹⁶ *Id.* at *8-12.

¹⁷ *Hooker*, 2011 U.S. Dist. LEXIS 57005, at *19 (“[a]lthough the concerns raised in this order appear in many foreclosure cases pending before me, I resolve the current controversy on narrow grounds”).

¹⁸ *Id.* at *8.

Life on MERS: Mapping the Landscape

Nevertheless, the *Hooker* decision joins a number of federal decisions in Oregon that seem to read Oregon's non-judicial foreclosure statute as requiring the recording of any intermediary assignments (regardless of whether the deed of trust named MERS as nominee) that may be contemplated by the pooling and servicing agreements.¹⁹

Thus, while these decisions have attracted attention for their occasional critical language of MERS, none of the cases holds that MERS cannot assign a deed of trust or that its existence is somehow unlawful. Nowhere in *Silverberg*, for example, does the New York court find that MERS cannot assign a mortgage, but rather, the court appears to merely clarify MERS's status as a noteholder or assignee of the note.²⁰ Indeed, several of the Oregon decisions affirm MERS's ability to assign a deed of trust. For example, in *Bertrand v. SunTrust Mortgage Inc.*,²¹ an Oregon federal district court recently held that MERS could act as a beneficiary under the deed of trust and could also assign its beneficial rights.²² Because all necessary assignments were recorded (at least as far as the court was concerned), the *Bertrand* court confirmed the validity of the non-judicial foreclosure brought by the noteholder.²³

To be sure, the *Saurman* decision and certain of the Oregon decisions rely upon the nuances of the particular state non-judicial foreclosure statute involved and, therefore, have limited application beyond their jurisdictional confines.²⁴ Nevertheless, the actual holdings of these cases have not prevented the foreclosure defense bar from misinterpreting their import.

The Majority of Decisions Are Rejecting Challenges to MERS

Despite the publicity cases such as *Silverberg*, *Saurman*, and *Hooker* have received in recent weeks, courts around the country continue to reject borrower challenges to the role of MERS.

¹⁹ See, e.g., *McCoy v. BNC Mortgage, Inc. (In re McCoy)*, 446 B.R. 453, 457 (Bankr. D. Or. 2011) (concluding that "[c]omplaint sets out a plausible claim that one or more assignments from [the originator] were unrecorded"); *Ekerson v. Mortgage Elec. Registration Sys.*, No. 3:11-cv-178, 2011 WL 597056, at *3-4 (D. Or. Feb. 11, 2011) (entering TRO where plaintiff alleged that MERS has failed to record all assignments); *Barnett v. BAC Home Loan Servicing, L.P.*, --- F. Supp. 2d ---, 2011 WL 723046, at *4-6 (D. Or. Feb. 23, 2011) (court issued TRO where it determined that complaint stated plausible claim that intermediate assignments had not been recorded); *Burgett v. Mortgage Elec. Registration Sys., Inc.*, No. 6:09-cv-6244, 2010 WL 4282105, at *2-3 (D. Or. Oct. 20, 2010) (affirming MERS's ability to assign a deed of trust, but denying defendants' motion for summary judgment upon court's conclusion that the record did not reflect that all required assignments had been recorded).

²⁰ *Silverberg*, slip op. at 6-9 ("[i]n a mortgage foreclosure action, a plaintiff has standing where it is both the holder or assignee of the subject mortgage and the holder or assignee of the underlying note at the time the action is commenced").

²¹ No. 09-875-JO, 2011 WL 1113421 (D. Or. Mar. 23, 2011).

²² *Id.* at *3-6 (granting defendants' motion for summary judgment and holding that MERS was a proper beneficiary under the Oregon Trust Deed Act and affirming challenged non-judicial foreclosure where summary judgment record reflected all necessary recorded assignments).

²³ *Id.* at *6.

²⁴ This is made clear in the *Saurman* decision, where the Michigan Court of Appeals rejected the foreclosing parties' reliance upon a Minnesota case that approved of and affirmed MERS's role in foreclosure proceedings. *Saurman*, slip op. at 8 ("the Minnesota statute specifically provides for foreclosure by advertisement by entities that stand in the exact position that MERS does here").

Life on MERS: Mapping the Landscape

For example, less than three weeks before the issuance of the *Hooker* opinion, the Oregon Circuit Court for Deschutes County granted MERS's motion to dismiss an action to stop foreclosure, because the "[p]laintiff designated [MERS] as the beneficiary when she accepted the benefits of the loan."²⁵ The court stated that it was "unpersuaded that [MERS] cannot act in that capacity, even if it is not the holder of the note."²⁶ The court also declined the borrower's invitation to require the recording of multiple intermediary assignments, as has been required by some federal court judges in Oregon.²⁷

Similarly, the California Court of Appeal for the Second District recently issued a decision rejecting a challenge to a non-judicial foreclosure sale where MERS assigned the deed of trust to the foreclosing entity.²⁸ The court found that there was no defect in the foreclosure proceedings where the deed of trust "explicitly provided MERS with the authority to" act as the nominee of the lender and its assigns.²⁹ The court held that MERS and its appointed foreclosure trustee may initiate foreclosure proceedings, even where MERS is not the holder of the original promissory note. Notably, the court also held that MERS and its appointed foreclosure trustee may raise the borrower's failure to tender the outstanding loan amount as a defense to a wrongful foreclosure suit under California law, even though MERS only holds legal title to the deed of trust.³⁰

The Bankruptcy Court for the District of Kansas issued a decision concluding that the MERS process, whereby the note and mortgage may be split, does not defeat the enforceability of either instrument.³¹ In the decision, the court distinguished a pair of Kansas state court decisions that had been viewed as calling MERS's authority into doubt and reasoned that "the agreement between [MERS and its member] could . . . result in a scenario where [the member] could assign the Note to MERS, and MERS (as the new holder of the Note) could bring the foreclosure action on [the member's] behalf."³² The court concluded that MERS had presented sufficient evidence of an agency relationship by which it acted on behalf of its member and, therefore, could proceed with enforcing the mortgage through foreclosure.³³ The U.S. Bankruptcy Court for the Southern District of Georgia similarly found that "the designation of MERS as nominee and its powers and duties was explicit," because "[t]he language used in the Security Deed [was] sufficient to create an agency relationship."³⁴ Like other courts before it, the Georgia bankruptcy

²⁵ See *Spencer v. Guaranty Bank, FSB*, No. 10CV0515ST, slip op. at 2 (Or. Cir. Ct. May 5, 2011).

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Ferguson v. Avelo Mortgage, LLC*, --- Cal. Rptr. 3d ----, 2011 WL 2139143, at *1, *3 (Cal. Ct. App. Jun. 1, 2011).

²⁹ *Id.* at *4-5. Further, the borrowers had conceded "that MERS had the authority to assign its beneficial interest to" the defendant. *Id.* at *5.

³⁰ *Id.* at *5 (quotations and formatting omitted).

³¹ See *Martinez v. Mortgage Elec. Registration Sys., Inc. (In re Martinez)*, Adv. No. 10-7027, 2011 Bankr. LEXIS 493, at *31-33 (Bankr. D. Kan. Feb. 11, 2011).

³² *Id.* at *30.

³³ *Id.* at *33-36.

³⁴ *Drake v. Citizens Bank of Effington (In re Corley)*, Adv. Proc. No. 10-4033, 2011 Bankr. LEXIS 807, at *11 (Bankr. S.D. Ga. Feb. 7, 2011).

Life on MERS: Mapping the Landscape

court rejected the argument that the splitting of the security instrument from the note through the MERS system effectively leaves the promissory note unsecured.³⁵

Such rulings have not been limited to the bankruptcy courts. For example, some courts have dismissed claims that MERS was not authorized to foreclose or that the use of the MERS system rendered the debt and security instruments unenforceable.³⁶ Others have rejected tort claims against MERS and its members, often arising in cases where foreclosure is imminent and the plaintiff asserts any and all claims that can be thought of to try to stop the sale.³⁷

The MERS MDL: New Developments

As noted in a previous K&L Gates alert, the Judicial Panel on Multidistrict Litigation has formed a multidistrict litigation proceeding in the United States District Court for the District of Arizona, styled *In re Mortgage Electronic Registration Systems, Inc. (MERS) Litigation* (the “MERS MDL”).³⁸ The proceedings before Judge James A. Teilborg are designed to address pre-trial matters with respect to federal cases that either allege “that ‘the various participants in MERS formed a conspiracy to commit fraud and/or that security instruments are unenforceable or foreclosures are inappropriate due to MERS’s presence as a party’ or that otherwise concern the ‘formation and operation’ of MERS.”³⁹

Having already granted motions to dismiss in six putative class actions in September 2010, in January of this year, Judge Teilborg granted another forty motions to dismiss

³⁵ *Id.* at *15-16. *But see In re Agard*, No. 10-77338-REG, 2011 Bankr. LEXIS 488, at *29-59 (Bankr. E.D.N.Y. Feb. 10, 2011) (court concluded that *Rooker-Feldman* doctrine prevented adversary proceeding to challenge foreclosure sale, but stated, in dicta, that MERS lacked authority under New York law to assign a security instrument).

³⁶ *See, e.g., Wade v. Meridias Capital, Inc.*, No. 2:10CV998 DS, 2011 U.S. Dist. LEXIS 28414, at *6-8, *9-10 (D. Utah Mar. 17, 2011) (“[u]nder the plain terms of the Trust Deed, which [plaintiff] signed, MERS was appointed as the beneficiary and nominee for the Lender and its successors and assigns and granted power to act in their stead, including making assignments and instituting foreclosure”); *Selby v. Bank of Am., Inc.*, No. 09cv2079 BTM(JMA), 2011 U.S. Dist. LEXIS 25427, at *20 (S.D. Cal. Mar. 14, 2011) (“[t]here is no merit to Plaintiff’s theory that assignment of the note nullifies MERS’s status as a nominee for the holder of the note”); *Karl v. Quality Loan Serv. Corp.*, 3:10-cv-00473-RCJ-VPC, 2010 U.S. Dist. LEXIS 137841, at *14-15 (D. Nev. Dec. 29, 2010) (“[t]here is no question of fact that QLS filed the NOD as the agent of MERS, who was the agent of the beneficiary UAMC, and the foreclosure was therefore not improper”); *Kane v. Bosco*, No. 10-CV-01787-PHX-JAT, 2010 U.S. Dist. LEXIS 128746, at *31-32 (D. Ariz. Nov. 23, 2010) (“the Court fails to see how the MERS system lacks authority as a nominee of lenders to assign deeds of trust, and how, in assigning deeds of trust, commits fraud or records forged or false documents”); *Richardson v. CitiMortgage, Inc.*, No. 6:10cv119, 2010 U.S. Dist. LEXIS 123445, at *13-15 (E.D. Tex. Nov. 22, 2010) (“[t]he role of MERS in this case was consistent with the Note and Deed of Trust”); *Kiah v. Aurora Loan Servs., LLC*, No. 10-40161-FDS, 2010 U.S. Dist. LEXIS 121252, at *9-11, *17 (D. Mass. Nov. 16, 2010) (“the mortgage explicitly granted MERS the power that plaintiff claims it did not have”).

³⁷ *See, e.g., Peelua v. Impac Funding Corp.*, No. 10-00090 JMS/KSC, 2011 U.S. Dist. LEXIS 29013, at *12-14 (D. Haw. Mar. 18, 2011) (granting dismissal on breach of fiduciary duty claim against MERS); *Gomez v. World Sav. Bank FSB*, 1:10-cv-01463-OWW-DLB, 2010 U.S. Dist. LEXIS 131674, at *11 (E.D. Cal. Dec. 13, 2010) (rejecting MERS conspiracy claim); *Josephson v. EMC Mortgage Corp.*, 2:10-CV-336 JCM (PAL), 2010 U.S. Dist. LEXIS 128053, at *6 (D. Nev. Nov. 19, 2010) (same); *Anderson v. Deutsche Bank Nat’l Trust Co.*, No. 2:10-CV-1443 JCM (PAL), 2010 U.S. Dist. LEXIS 120865, at *9 (D. Nev. Oct. 29, 2010) (same); *Gomes v. Countrywide Home Loans, Inc.*, 192 Cal. App. 4th 1149, 1157 (2011) (upholding MERS’s authority to foreclose because plaintiff consented to such by signing deed of trust). For additional cases concerning MERS see our earlier client alert at <http://www.klgates.com/newsstand/Detail.aspx?publication=6709>.

³⁸ K&L Gates LLP represents certain defendants in the MERS MDL.

³⁹ MERS MDL, No. 09-2119-JAT, 2010 WL 2266663, at *1 (D. Ariz. Jun. 4, 2010).

Life on MERS: Mapping the Landscape

filed in fourteen other individual actions that had become part of the MERS MDL.⁴⁰ In so doing, Judge Teilborg concluded that plaintiffs had failed to state claims for wrongful foreclosure, conspiracy to commit wrongful foreclosure, fraud in the inducement, conspiracy to commit fraud, intentional/negligent misrepresentation, slander of title, quiet title, and unjust enrichment.⁴¹ The court rejected plaintiffs' prayers for injunctive and declaratory relief, rescission, and reformation of contract as those forms of relief rested upon the failed claims.⁴² Nevertheless, the court did provide all plaintiffs leave to amend in order to file a consolidated complaint.⁴³ Indeed, in a recent order, the court stated that "[u]nless the common allegations of every member case in this MDL can be stated with sufficient plausibility to survive *Twombly* and *Iqbal*, every claim transferred to this MDL will fail. This consolidated complaint should be a good test of whether or not this can be done."⁴⁴ Plaintiffs filed their consolidated amended complaint on June 4, 2011. The court is set to hear argument on defendants' motions to dismiss the consolidated amended complaint in Phoenix later this summer.

Other Challenges to MERS

As noted in our prior client alert, borrowers have filed complaints alleging that the formation and operation of MERS constitutes an unlawful enterprise under civil racketeering laws. To date, these cases have gained little traction.⁴⁵

In other cases, plaintiffs in California and elsewhere filed lawsuits under state false claims act statutes alleging that the MERS system is designed to unlawfully avoid county recording fees and other taxes payable upon the recording of instruments in local land registries. While many of these cases are still in their incipient stages, in at least one early filed action, a California federal court dismissed a false claims act lawsuit against MERS and others where the alleged "fraudulent scheme" to deprive local county government of fees and taxes based on the designation of MERS as a nominee on deeds of trust was information already available to the public and that the plaintiff relator was not the original source of the information.⁴⁶

Conclusion

Read in their proper context, decisions such as *Silverberg*, *Saurman*, and *Hooker* merely confirm that in certain jurisdictions, MERS and its members may need to take a few extra steps to comply with applicable non-judicial foreclosure procedures. At most, these cases serve as a reminder that MERS-

⁴⁰ MERS MDL, No. 09-2119-JAT, 2011 WL 251453, at *1 (D. Ariz. Jan. 25, 2011).

⁴¹ *Id.* at *4-10.

⁴² *Id.* at *11.

⁴³ *Id.*

⁴⁴ MERS MDL, No. 09-2119-JAT, slip op. at 2:4-7 (Doc. No. 1413) (D. Ariz. May 6, 2011).

⁴⁵ For example, in *Foster v. Mortgage Electronic Registration Systems Inc.*, No. 10-cv-611 (W.D. Ky.), a putative class action alleging violations of civil RICO filed last fall in Kentucky -- a case that attracted media attention at the time of its filing -- the class action complaint was voluntarily dismissed by the named plaintiffs before any defendant was formally served.

⁴⁶ *California ex rel. Bates v. Mortgage Elec. Registration Sys., Inc.*, 2:10-cv-01429-GEB-CMK, 2011 WL 892646, at *3-5 (C.D. Cal. Mar. 11, 2011).

Life on MERS: Mapping the Landscape

related jurisprudence continues to develop. And while the legal landscape may seem uncertain (including conflicting intra-jurisdictional outcomes), these decisions do not support the unfounded conclusion that in all cases, the identification of MERS as nominee on a deed of trust or mortgage prohibits the proper assignment of the deed of trust or mortgage to the noteholder, or that the MERS system is flawed or corrupt. To the contrary, a majority of courts across the country continue to recognize the valid and beneficial role MERS serves in the mortgage industry.

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Mortgage Banking & Consumer Financial Products

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