



Update on Legal Issues in Mortgage Technology

MBA Legal Issues and Regulatory Compliance Conference

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- Electronic Originations
 - » Electronic delivery of disclosures – New Fed rules
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 - » Road to eMortgages – Warehouse lending paper
 - » Admissibility of Electronic Evidence
- Electronic Compliance and Risk Management
 - » Automated compliance engines and risk management
 - » Litigation and repurchase risks
- Q and A

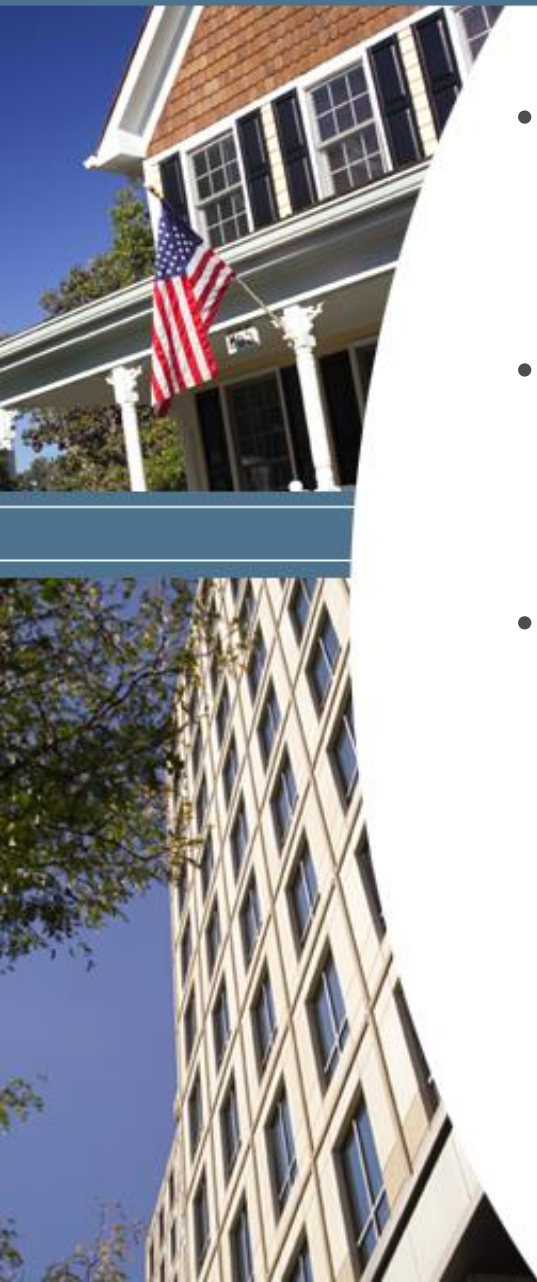


New Federal Rules on Electronic Delivery of Disclosures

- The Electronic Signatures in Global and National Commerce Act (ESIGN) enacted in 2000 (15 U.S.C. § 7001 et seq.)
- Provides that electronic documents and electronic signatures have the same validity as paper documents and handwritten signatures
- Contains special rules for the use of electronic disclosures in consumer transactions:
 - » Disclosures must inform consumer of the option to receive disclosures in paper form, the right to withdraw consent, how to obtain paper copies, and the hardware/software requirements for access and retention.
 - » Consent must be obtained electronically in a manner that reasonably demonstrates that the consumer will be able to access required notices or disclosures electronically.

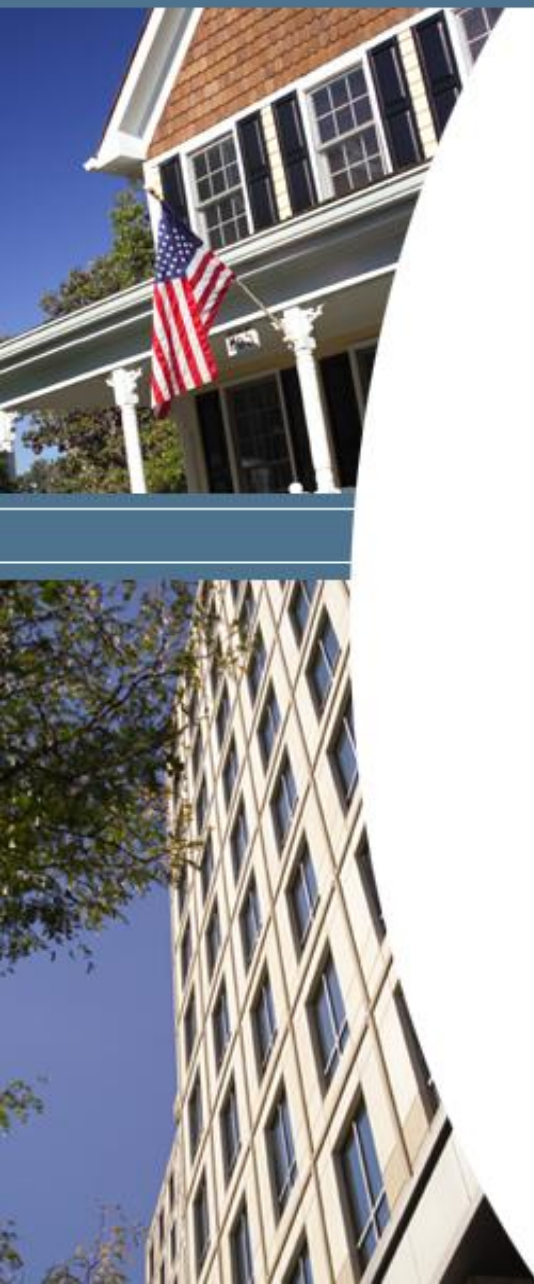
- Federal Reserve Board attempted to establish uniform standards for the electronic delivery of disclosures in 2001 for Regulations B, E, M, Z and DD.
- Withdrew mandatory compliance date of October 1, 2001 because of operation and information security concerns by commenters.
- Highlights of the 2001 Interim Final Rules:
 - » Distinguished between transaction-specific disclosures, which required an E-SIGN consent and non-transaction specific disclosures, which did not.
 - » Allowed disclosures to be delivered to consumer's email address or posted on another website;
 - » If posted on a website, the consumer must be alerted by email of the availability of the disclosures
 - » Disclosures posted on a website must be available for at least 90 days;
 - » Creditors required to make a good faith effort to redeliver electronic disclosures that were returned undeliverable.

- Mandatory Compliance Date: October 1st, 2008
- General provisions for electronic delivery under Regulations B and Z:
 - » Disclosures can be provided in electronic form, provided that creditor complies with consumer consent and other applicable provisions of ESIGN;
 - » No ESIGN consent required for shopping disclosures under Reg Z or application-related disclosures under Reg B;
 - » If loan application is accessed electronically, the format of application-related disclosures:
 - Must be electronic if accessed on a personal computer (i.e., home computer); or
 - May be electronic if accessed at creditor’s office or the office of an affiliate or third party with a contractual obligation to creditor to provide applications


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- No requirement to deliver disclosures via email nor send an alert to the consumer of their availability on a specific website;
 - No requirement to attempt redelivery of an email disclosure that has been returned undeliverable; and
 - No requirement to keep disclosures posted on a website for at least 90 days.



- Continues to allow creditor to deliver one electronic copy of notice of right to rescind to each entitled consumer.
- Expanded and flexible guidance for determining how to present disclosures that are required to be “on or with the application”:
 - » Automatic presentation on screen when application appears;
 - » Presenting disclosures on same page as application, if application clearly and conspicuously indicates location of the disclosures and that they contain rate, fee and other cost information;
 - » Providing a link to the electronic disclosures that cannot be bypassed by the consumer before submitting the application; or
 - » Locating disclosures on same web page as the application, not necessarily on initial screen, immediately before the submit button.



Countrywide Home Loans Countrywide: Start Online

 **Countrywide** | HOME LOANS Sample Site
(818)555-5555

▶ **START** • BORROWER INFORMATION • ASSETS • DEBT • LOAN REQUEST • GENERAL • SUBMIT



Expectation | **Consent to Receive Electronic Disclosures** | [Electronic Disclosures](#)

Important! In connection with the "START ONLINE" process, we have provided important disclosure documents below. You should review, print and/or download copies of the disclosures to retain for your permanent records.

To access, click "View" next to the PDF icon for each disclosure.


After viewing your disclosures, you will need to check the box below and select "NEXT" to proceed.

✓ Viewed

Application Disclosure Handbook	3,997 KB	 View
Consumer Handbook on Adjustable Rate Mortgages (CHARMs) Booklet	100 KB	 View

By clicking this box, I acknowledge having read and received all the disclosures listed above.*

NEXT

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- Clear and conspicuous disclosures;
- Retainable form;
- Request to delay disclosures for hand-held devices; and
- Request to expand exception from ESIGN notice and consent requirements.

- Greater flexibility to provide innovative ways to provide electronic disclosures.
- Less tied to particular technology.



E-Business Risks and Mitigation Plan



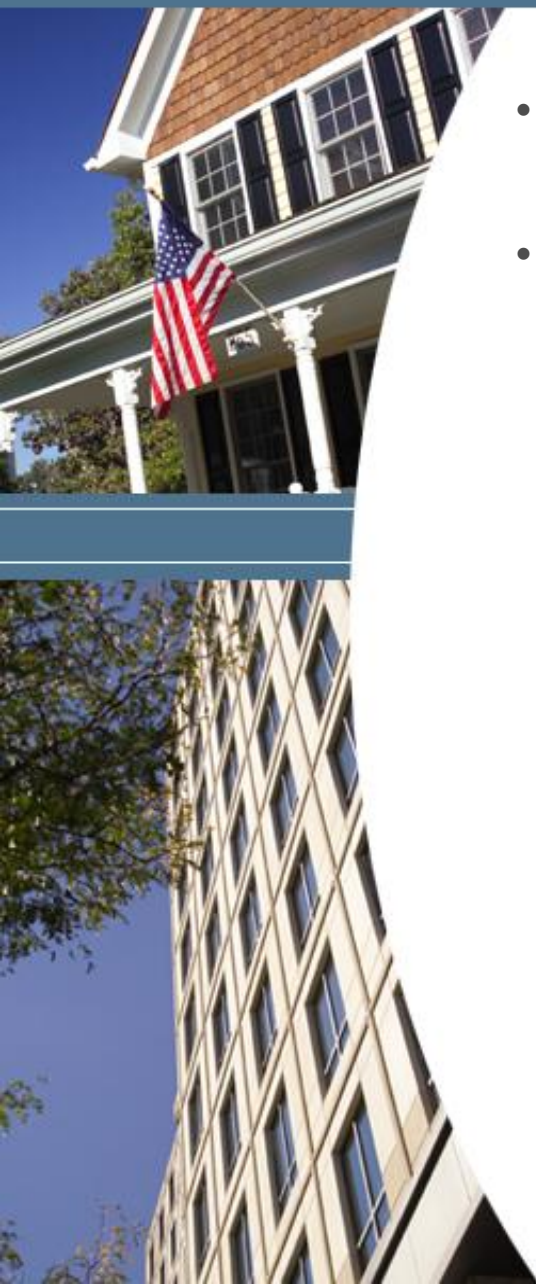
BUCKLEY KOLAR LLP

HIGH LEVEL IDENTIFICATION OF EBUSINESS RISKS AND MITIGATION PLAN

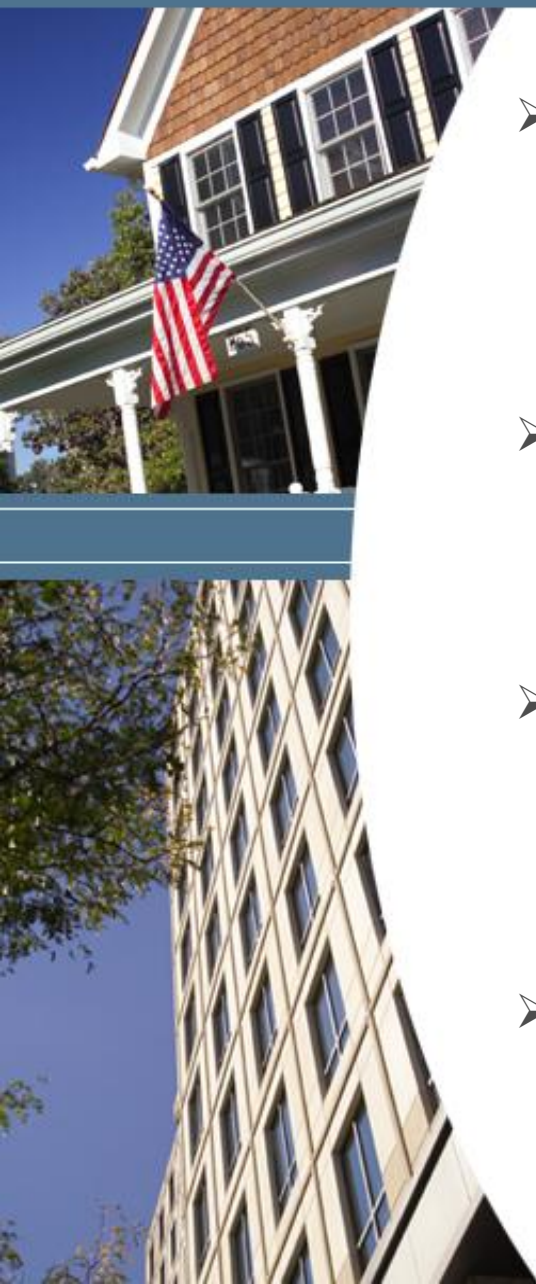
Transaction Stage	Risk	Entities Exposed	Legal/Third Party Requirements	Consequence/ Penalties	Mitigation Methods	Contracts	Insurance (E&O, other)	Legal Opinion	Business Process Controls/ Standards	Audit
					Due Diligence					




Web-Based Closings



- Not an eSignature process – More of a hybrid loan closing.
- Overview
 - » Internet-based, web-conferencing portal and telephone conference call used to display and review loan closing documents with borrowers and other required non-borrower parties;
 - » Closing agent reviews the loan closing documents with borrowers and obtains their assent for borrowers' attorney-in-fact to properly complete, sign and date the documents.
 - » A hard copy of each loan document is then executed by the attorney-in-fact pursuant to a limited power of attorney, which is required to be executed by each borrower, notarized, and delivered to the closing agent on or before the closing date.



- Alternative closing option for consumer
 - Borrowers can close their loans from the comfort of their home or any other location with high-speed internet access
 - Capable of closing loans up to midnight
 - Borrowers choose the time most convenient for them
- Reduces need for dual signings and delayed closing appointments
 - Borrowers can be geographically disparate but still present for the same closing appointment
- Higher quality closings
 - Closings performed by knowledgeable closing agents instead of mobile notaries
 - Closings are recorded and more structured than traditional closings
- Interim step towards full eMortgage closing



**Security Interests in Transferable Records and the Rights of
Warehouse Lenders**

- How does a warehouse lender perfect its interest in an electronic note (“eNote”) when traditional paper note protections, such as bailee agreements and letters, are inapplicable to eNotes?

- UCC Article 9 Perfection – Perfect by filing, but a holder in due course or a secured party in possession will take priority. As a result, virtually all warehouse lenders will take possession of a negotiable paper promissory note.
- Investor requirements – Investors will not purchase without (1) being able to inspect the paper note; and (2) having it in their possession.
- UCC § 9-313(h) – Warehouse lender can relinquish possession to an investor without losing priority if the note is accompanied by instructions to the investor to either (1) hold possession for warehouse lender's benefit; or (2) redeliver the note to the warehouse lender if the sale is not completed.

- A “transferable record” and “control” are substitutes for the concepts of a paper negotiable instrument and possession.
- Transferable record definition – An electronic record that:
 - » would be a note under UCC Article 3 if the electronic record were in writing; and
 - » in which the issuer (i.e., borrower) of the electronic record has expressly agreed it will be treated as an electronic record.
 - » ESIGN additionally requires the electronic record to relate to a loan secured by real property.
- A person has “control” of a transferable record (“eNote”) if the system employed for evidencing the transfer of interests in the eNote reliably establishes that person as the person to whom the eNote was issued or transferred.


- Designed by and for the mortgage industry to be the system for establishing control of an eNote.
- Language in the eNote will specifically point to the MERS® eRegistry as the central location to identify the person in control “Controller” and the location of the AC of the eNote.
- But the eRegistry alone doesn’t solve the investor vs. warehouse lender dilemma.

- Except as otherwise agreed by the Transferor and Transferee, in the event a Transferee accepts Control of an eNote without first giving value for the transfer, then until such time as value is given with respect to the eNote, the Transferee shall hold the eNote as designated custodian for the Transferor as provided for under 15 USC 7021(c)(3) and Section 16(c)(3) of the UETA, as applicable.



Admissibility of Electronic Evidence

- Reliable record retention system is critical for a number of reasons to:
 - » Comply with state or federal “writing” and “original” requirements
 - » Meet state or federal record retention requirements
 - » Obtain admission of electronic records into evidence in the event of a dispute (Authenticity and Best Evidence)
- Judge Grimm in *Lorraine v. Markel American Ins. Co.*, 241 F.R.D. 534, 538 (D.Md. 2007):
 - » [C]onsidering the significant costs associated with discovery of ESI, it makes little sense to go to all the bother and expense to get electronic information only to have it excluded from evidence or rejected from consideration during summary judgment because the proponent cannot lay a sufficient foundation to get it admitted.

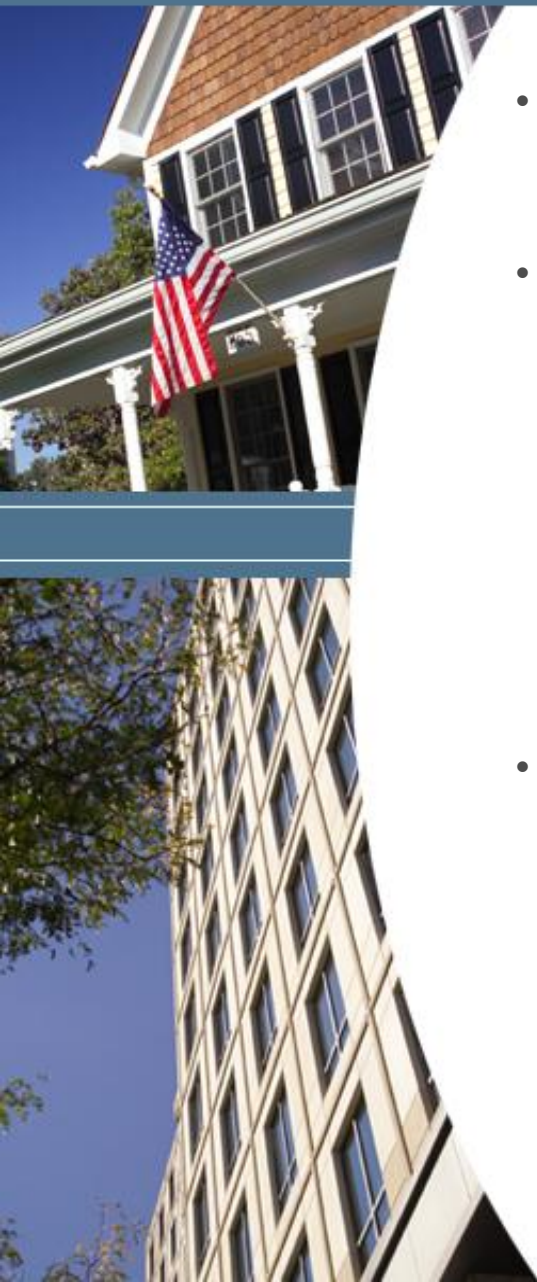


ESIGN and UETA focus on the accurate preservation of, and access to, the information contained in the electronic record:

- » The record holder must be prepared to demonstrate that the electronic record:
 - » Accurately reflects the information contained in the record at the time it was signed or delivered,
 - » Is accessible to anyone entitled to access the record holder's copy of the Record under an applicable rule of law or agreement,
 - » Can be accurately reproduced for later reference, and
 - » Is capable of being retained by transaction participants to whom it has been made available for review or signature.

(See ESIGN Section 101(d) and (e) and UETA Section 12)

- Courts are only allowed to consider evidence that is admissible. What does this mean?
- In order to be admissible, the records, among other things (relevancy, etc) must be authentic (FRE Rule 901)
- The mere fact that information has been created and stored within a computer system does not make that information reliable or authentic.



- The primary authenticity issue as identified by the court in *In Re Vee Vinhnee*, 336 B.R. 437 (9th Cir. BAP (Cal.) 2005), focuses on:
 - . . . what has, or may have, happened to the record in the interval between when it was placed in the files and the time of trial. In other words, the record being proffered must be shown to continue to be an accurate representation of the records that originally was created Hence, the focus is not on the circumstances of the creation of the record, but rather on the circumstances of the preservation of the record during the time it is in the file so as to assure that the document being proffered is the same as the document that was originally created.
- Methods used to authenticate records are set forth in FRE 901 and 902. For computer stored records and data:
 - » Witness with personal knowledge (901(b)(1))
 - » Expert Testimony (901(b)(3))
 - » Distinctive Characteristics (e.g., hash value) (901(b)(4))
 - » System or process capable of proving a reliable result (901(b)(9))
 - » Certification (902)

- 11-factor foundation process for electronic records:
 - » The business uses a computer.
 - » The computer is reliable.
 - » The business has developed a procedure for inserting data into the computer.
 - » The procedure has built-in safeguards to ensure accuracy and identify errors.
 - » The business keeps the computer in a good state of repair.
 - » The witness had the computer readout certain data.
 - » The witness used the proper procedures to obtain the readout.
 - » The computer was in working order at the time the witness obtained the readout.
 - » The witness recognizes the exhibit as the readout.
 - » The witness explains how he or she recognizes the readout.
 - » If the readout contains strange symbols or terms, the witness explains the meaning of the symbols or terms for the trier of fact.
 - » *Id.* at 14 (citing Edward J. Imwinkelried, *Evidentiary Foundations* § 4.03[2] (5th ed. 2002)).
- The court focused on the 4th factor and noted that for electronically stored information:
 - » [t]he logical questions extend beyond the identification of the particular computer equipment and programs used. The entity's policies and procedures for the use of the equipment, database, and programs are important. How access to the pertinent database is controlled and, separately, how access to the specific program is controlled are important questions. How changes in the database are logged or recorded, as well as the structure and implementation of backup systems and audit procedures for assuring the continuing integrity of the database, are pertinent to the question of whether the records have been changed since their creation.
 - » *Id.* at 444-45.

- Record management control procedures should include:
 - » Control of access to databases
 - » Recording and logging of changes
 - » Backup practices
 - » Audit procedures
 - » Media deterioration
 - » Data migration
 - » Encryption of executed documents to prevent undetected alteration
- Preservation evidence: screen shots, process flows, affidavit, good witness
- (*Person v. Google; Bar-Ayal v. Time Warner, American Express v. Vin Vinhnee*)
- A good witness; or certification document



Questions?