nerej
CELEBRATING 55 YEARS

Daniel Morris - Nationalization of the mortgage lending process: Why do we submit an application for the title insurance contract even if the required releases are not of record?

June 23, 2011 - Spotlights

What has happened in our industry? Today, contracts and legal enforcement of these contracts undergirds the title insurance industry's very existence! When I was first exposed to the residential property secured transaction, I had to learn the purpose and importance of every document in the mountain of papers my clients were required to sign. The most perplexing at the time was the purpose of the title commitment or binder. In law school, I learned that this document is essentially a promise for a promise - e.g. a contract drafted by the insurance company's agent with the conditions, restrictions and requirements necessary to enter into an insurance agreement (policy).

Historically, the requirements on the title commitment were a "condition precedent" to the formation of the insurance contract. As such, the attorney reviewing the title abstract and forming a legal opinion of the requirements, necessary to bind coverage for the originating lender, would "mark-up" the title commitment to confirm the completion (or objection) of said requirements before submitting an application for title insurance. Back then, I was not permitted to apply for a title insurance contract until all of the conditions were fully satisfied, unless the insurer agreed to remove any unfulfilled conditions.

This process has changed over the years. Slowly, a propensity to look away or overlook a condition has become tolerable. Tolerable? Why is it tolerable to proceed with a contract when the conditions to enter into that contract have not been met? The most notable among overlooked conditions is the requirement to cancel the underlying obligation and release the lien of a superior mortgage of record. The industry has become numb to this condition, and essentially ignores it or treats it with the "cure-all" indemnity agreement, what many speakers in our industry refer to as one of my industry colleagues (who understandably wants to remain anonymous) calls the "tolerance of sloppiness."

Wherein lays the impetus behind this loosening of conditions? In my investigation, I learned that the primary culprit is the nationalization of the mortgage lending process. When mortgage lenders began originating loans nationwide, and the town bank slowly gave way to the mega multi-national lender, the result was the nationalization of loan servicing and release or reconveyance of the mortgage lien when paid off. The sheer scale of loans being serviced and the diversity of state laws and regulations affecting these loans created complexity contributing to the delayed processing of releases of paid off liens. Soon, it was commonplace that releases were delayed far beyond the statutory period and in some cases the release was lost in the confusion.

As the markets grew, so did the magnitude of the problem of lien release. Attorneys were delaying the application for title insurance pending the release, underwriters were prevented from accepting

the premiums, and originating lenders were screaming for their title policies under pressure from investors in the secondary market. The underwriters and the attorney agents, relying on a statutory duty of the paid off lenders to release, opted to permit the application for title insurance so long as the other requirements were met. Submission of an affidavit that the disbursement check or wire of the underlying payoff was accepted or cashed was in many cases sufficient to fulfill the requirement, and therefore the premium could be remitted and the policy delivered.

So what does this mean? We now experience significant increase in claims for unreleased liens - particularly in the case of foreclosures. This laxity has opened door for fraud and defalcation especially in the case of Home Equity Lines Of Credit - HELOCs. After all, how often do we call the paid off lender to confirm they closed the account and recorded the lien release?

State laws regulate the lender's requirements to release or cancel the mortgage lien. The lender or servicer must comply with these laws or face penalties or damages that range from a slap on the wrist to in some jurisdictions liability to the borrower in an amount up to a percentage of the original loan amount. These penalties, however, have not had the deterrent affect intended.

The fact is the pressures in the business of title insurance, the demands from lenders to get their policies issued and the cure-all indemnity band-aids have all contributed the lien release problem. We are now cleaning up the ugly and costly mess of these unreleased liens and must learn from our mistakes. It is time to examine our post-closing lien release practices and establish follow-up procedures to prevent the lien release problem from having a direct effect on our clients. In a future article I will examine some practices and services to help each of us in contributing to a solution to this problem.

Daniel Morris is the founder and CEO of reQuire, LLC, Virginia Beach, Va.