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A Glance at the Impact of the Subprime Mortgage Crisis on the Title Insurance Industry

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Introduction

The mortgage and financial industry crisis has impacted the title insurance industry on many fronts. Foreclosure filings, claims losses, and real estate sales inventories are at unprecedented highs. Simultaneously, property values, real estate transactions, and the accompanying title insurance premium dollars are at their lowest level in decades.

The increase in foreclosure filings in New York has precipitated a host of new statutes aimed at avoiding the loss of residential properties to foreclosure and protecting homeowners from unscrupulous lenders, brokers, and "foreclosure rescuers." As this surge of foreclosure proceedings winds its way through the courts, new procedures have been implemented and new case law is developing. In turn, these legislative efforts, together with recent court programs and decisions, have added another layer of risk to the title underwriting process at a time when many title insurers are reeling from huge claims losses and pressure from investors to cut costs.

Moreover, the pressure to reduce losses has caused massive layoffs, brought about the closing of many title insurance offices, and triggered underwriters to terminate hundreds of title agency agreements. The combination of layoffs and terminated agency relationships has cost the title industry hundreds of years of historical knowledge and expertise as these title experts search for new employment.

This essay will discuss these issues and how they have

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changed the way title insurance companies currently do business, particularly in the New York market.

I. Changes in the Marketplace

The numbers are staggering. Mortgage foreclosure rates as of the end of 2008 were up 225% from the end of 2006, and up 81% from the end of 2007.[1] Property values have fallen to levels not seen since the third quarter of 2003[2] and are estimated to be down 11.6% nationally in 2008 alone.[3] Loan to Value Ratios on mortgaged properties are "upside-down" or "underwater."[4] Further, 17.6% of homeowners owe more on their mortgages than their properties are worth[5] and almost half of subprime borrowers were "underwater" in September 2008.[6]

The loss of available equity in many properties, coupled with stricter underwriting guidelines requiring lower loan to value ratios and higher credit scores, has made it impossible for many homeowners to refinance their mortgages. At the same time, real estate sales are extraordinarily slow. Even after taking into account December's 11.7% drop in the national inventory of unsold homes, a 9.3 month supply still

1. Les Christine, *Foreclosures Up a Record 81% in 2008*, CNN MONEY, Jan. 15, 2009, http://money.cnn.com/2009/01/15/real_estate/millions_in_foreclosure/index.htm.

2. *U.S. Home Prices Fall at Highest Annual Rate Last Quarter*, INT'L HERALD TRIB., Feb. 24, 2009 (referring to Standard & Poor/Case-Shiller U.S. National Home Price Index).

3. ZILLOW, FOURTH QUARTER 2008 REAL ESTATE MARKET REPORTS (2009). *See also* Posting of Stan Humphries to Zillow Blog, http://www.zillow.com/blog/americans-lose-14-trillion-in-home-values-in-q4/2009/02/ (Feb. 2, 2009) (discussing report).

4. The terms "upside down" and "underwater" are terms of art used to describe a situation where the outstanding mortgage liabilities on the property exceed the value of the property.

5. Paul Jackson, *One in Six Borrowers Underwater on Mortgage, Zillow Says*, HOUSINGWIRE, Feb. 3, 2009, http://www.housingwire.com/2009/02/03/one-in-six-borrowers-underwater-on-mortgage-zillow-says/.

6. CREDIT SUISSE, REPORT ON FORECLOSURE TRENDS IN THE UNITED STATES, at 3 (Dec. 2008), *available at* www.nhc.org/Credit%20Suisse%20Update%2004%20Dec%2008.doc. Credit Suisse further projects that 72% of all subprime borrowers will be underwater by 2011. *Id.*

remains.[7] The supply is much higher in New York, particularly in the suburbs of Manhattan. Westchester County has an 18 month supply of homes on the market, and the supply is nearly the same in Orange County.[8] The supply is 20.9 months in Long Island and 14.5 months in Rockland County.[9] Across the river in Hudson, New Jersey, the numbers suggest it would take a staggering 24.1 months to exhaust the existing inventory of homes.[10]

The good news for potential purchasers is that it is a buyer's market and interest rates are down, which makes homes more affordable for those with a sizeable down-payment and good credit scores. Low interest rates seem to have spurred some recent refinance activity—which is certainly good news for the title industry—but purchase transactions remain relatively stalled. There appears to be collective breath-holding as prospective purchasers wait to see where the bottom is. Until purchasers take the plunge, however, the vicious cycle will continue. The vast inventory of homes on the market, coupled with the huge number of foreclosed homes that are a large part of that inventory, keep property values low. This leads to more foreclosures as adjustable rate mortgages reset to unaffordable payments that cannot be refinanced because the outstanding debt exceeds the equity in the property. All of which, in turn, leads to reduced title order counts—the lifeblood of title insurance revenues.

II. Financial Impact on Title Insurers

Unlike traditional property and casualty insurance lines that rely on annual premiums, title insurance does not generate recurring premiums. Rather, there is a one-time

7. Julie Haviv, *U.S. Housing Market May Have Turned a Pivotal Corner*, REUTERS, Jan. 27, 2009, http://www.reuters.com/article/reutersEdge/idUSTRE50P72M20090127.

8. Antoinette Martin, *Housing Inventories on the Rise*, N.Y. TIMES, Dec. 28, 2008, at RE5.

9. *Id.*

10. Helen Chernikoff, *As Wall Street Suffers, So Does Nearby New Jersey*, REUTERS, Dec. 31, 2008, http://www.reuters.com/article/companyNewsAndPR/idUSN3035225020081231.

premium paid at the time a title insurance policy is issued. The title insurance policy essentially continues as long as the insured retains an interest in the real property described in the policy and only lapses when there is a transfer of title to the property, or the mortgage on the property is paid in full, or refinanced. A new title insurance policy is generally bought in connection with the purchase, mortgaging, or leasing of real property. Thus, title insurers rely on real estate transactional volume for revenue.[11]

While title orders, particularly for refinance transactions, increased in December 2008 and January 2009, overall the title insurance business is down significantly from 2007 levels and drastically from 2006 levels. Even when these title orders are received, many transactions are not actually closing. A glimpse at the financial reports of three of the top five title underwriters discloses the extent of the decline.[12] First American Corporation reported a 16% drop in closed title orders in the fourth quarter of 2008, compared with the same time period in 2007.[13] Its 2008 title order count was down almost 18% from 2007 counts and down over 25% in the fourth quarter of 2007 from the same period in 2006.[14] Stewart Information Services Corporation reported a 14.6% decline in title orders in 2007 compared to 2006 orders and a 22.2%

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11. See TITLE INSURANCE: A COMPREHENSIVE OVERVIEW (James L. Gosdin ed., 3rd ed. 2007), for further information regarding the title insurance industry.

12. Based on the American Land Title Association's ("ALTA") 2008 third quarter market share figures, the top five title insurance underwriters in the United States were (1) First American Corporation's family of title underwriters; (2) Fidelity National Financial's family of companies; (3) LandAmerica's family of companies; (4) Stewart Information Services; and (5) Old Republic Title Insurance Company. AM. LAND TITLE ASS'N, 2008 THIRD QUARTER YTD MARKET SHARE FAMILY-COMPANY SUMMARY, *available at* http://www.alta.org/industry/08-03/Marketshare3rdQuarterfamcosummary.xls. Three of LandAmerica's underwriters were subsequently purchased by Fidelity National's underwriters on December 22, 2008, after LandAmerica filed for bankruptcy protection in late November 2008. *See, e.g.*, *Fidelity and LandAmerica Deal Creates Largest U.S. Title Insurer*, BEST'S REV., Jan. 1, 2009.

13. First American, First American's Title Order Transactions by Month for Direct Title Operations, http://www.firstam.com/titleordercounts.cfm (last visited Mar. 9, 2009).

14. *Id.*

decline in 2008 from 2007.[15] Fidelity National Financial, Inc.'s Fourth Quarter 2008 Report shows that title order counts were down over 17% in 2008 from 2007 and that, while 64% of all title orders received in the fourth quarter of 2007 actually closed in 2007, only 57% actually closed in 2008.[16]

At the same time as business was plummeting, title insurance claims were rising beyond all expectations, with the top five underwriters paying a combined total of approximately $967 million in claims in 2007.[17] A sampling of the numbers shows the devastation. First American Corp. reported its title claims jumped 62% in the first half of 2007 from the same period in 2006, which caused it to place $243.6 million more than expected in policy reserves[18] followed by a $50.7 million after-tax reserve strengthening in 2008.[19] Fidelity National Financial increased its reserves by $37.5 million dollars in the second quarter of 2008 and took a $261.6 million reserve strengthening charge in the third quarter of 2008.[20] This was after a $135.7 million reserve charge in the fourth quarter of 2007.[21] Stewart Information Services Corp. increased policy reserves by $32 million and $19.3 million for pending legal

15. Jonathan Stempel, *Stewart Title Parent Suffers Loss, Cutting Jobs*, REUTERS, Feb. 20, 2009, http://uk.reuters.com/article/bankingFinancial/idUKN2034096620080220.

16. First American, First American's Title Order Transactions by Month for Direct Title Operations, http://www.firstam.com/titleordercounts.cfm (last visited Jan. 21, 2010).

17. *National Underwriters Boost Reserves to Cover Claims in '07*, TITLE REP., May 5, 2008, at 5, *available at* http://www.stitle.com/pdf/the_title_report_may52008.pdf.

18. Annette Haddad, *Foreclosures Hit Title Insurer – First American Posts a Second-Quarter Loss as the Housing Downturn Increases Claim Filings*, L.A. TIMES, Aug. 3, 2007, at C3.

19. Press Release, First American Corp., The First American Corporation Reports Financial Results for the Fourth Quarter and Full Year 2008 (Feb. 26, 2009), *available at* http://www.firstam.com/ekcms/uploadedFiles/firstam_com/Investors/08Q4pressrelease.pdf.

20. Press Release, Fidelity National Financial, Inc., Fidelity National Financial, Inc. Reports Third Quarter EPS of ($0.95); Results Include a $261.6 Million Charge to Strengthen Reserve for Claim Losses, (Oct. 22, 2008), *available at* http://www.investor.fnf.com/releasedetail.cfm?ReleaseID=342588&COMPID=FNT.

21. Stempel, *supra* note 15.

matters in 2008[22] after taking a $40.9 million pre-tax reserve charge in 2007.[23]

In an attempt to stem the tide of these losses and keep their investors relatively happy, title insurers across the country are eliminating jobs and closing many of their offices to cut expenses. In September 2007, First American Corp. announced it would cut 1300 additional jobs (about 3% of its workforce), institute hiring and salary freezes, cut executive perks and benefits, and close forty of its 2500 branches to reduce expenses.[24] Additionally, in 2008, First American Corp. reported over 4100 job losses for the year (approximately 11% of its workforce).[25] Meanwhile, Fidelity National Financial, Inc. eliminated 1000 jobs in the third quarter of 2008, instituted a 10% company-wide pay reduction, and closed 115 offices.[26] Also, in one month alone (January 2009), Fidelity National Financial, Inc. cut 1500 of the 5500 employees and closed 125 of the offices it inherited as a result of its purchase of Lawyers Title Insurance Corp., Commonwealth Land Title Insurance Co., and United Capital Title Insurance Co.[27] These cuts by Fidelity came on the heels of LandAmerica's prior cumulative headcount reduction of 4200 between January 1, 2007 and July 30, 2008.[28] Fidelity's own cuts, not including those involving some of the assets of LandAmerica Financial

22. Anurag Kotoky, *Stewart Information Q4 Loss Widens, Shares Fall*, REUTERS UK, Feb. 19, 2009, http://uk.reuters.com/article/rbssFinancialServicesAndRealEstateNews/idUKBNG17791920090219?pageNumber=1&virtualBrandChannel=0.

23. *Steward Reports Operating Results for 2007*, AM. LAND TITLE ASS'N, Feb. 21, 2008, http://www.alta.org/indynews/news.cfm?newsID=6102.

24. Annette Haddad, *Deeper Cuts in Store for Title Insurer – Santa Ana-Based First American Will Lay Off 1,300 Workers and Close Dozens of Offices*, L.A. TIMES, Sept. 5, 2007, at C3.

25. Jonathan Stempel, *Title Insurer First American Posts Loss*, REUTERS, Feb. 26, 2009, http://www.reuters.com/article/companyNewsAndPR/idUSN2654463120090226.

26. Press Release, Fidelity National Financial, Inc., *supra* note 20.

27. Press Release, Fidelity National Financial, Inc., Fidelity National Financial Narrows 4Q Loss (Feb. 4, 2009), *available at* http://www.investor.fnf.com/releasedetail.cfm?ReleaseID=363544&compid=fnt.

28. *Large Claims Dampen LandAmerica Profits*, TITLE REP., July 30, 2008.

Group, numbered 500 in the fourth quarter of 2008 alone.[29] Stewart Information Services Corporation cut 1500 jobs in 2007,[30] closed 167 offices, and eliminated 2120 positions in 2008.[31] These numbers do not even touch the number of title professionals cut by other national and regional underwriters or those lost as thousands of title agencies made similar cuts across the country.

Some of the reasons advanced for the increase in claims are the large number of foreclosures, fraud claims, losses from home equity insurance products,[32] and agent defalcations.[33] The pressure from the lending community to search and close deals, especially mortgage refinance and home equity loan transactions, within twenty-four to forty-eight hours in many cases, led to a loosening of examination and underwriting standards. Claims resulting from home equity theft, identity theft, forgery and other frauds, particularly in connection with transfers of title without the payment of full consideration, are rampant. As mortgages went into default, underlying title issues began to surface and claims blossomed.

Concerns over agent defalcations and the overhead costs associated with maintaining non-productive agency relationships has led many title insurance underwriters to terminate their agency relationships with thousands of their agents. In New York alone, one title insurance company dedicated entirely to agency business terminated its relationship with all of its agents when its corporate parent elected to cease the subsidiary's operations in New York. At the same time, most of the national title insurers doing business in New York terminated agency relationships with many of their agents. These cuts were not, however, limited to

29. Fidelity National Financial, Inc., Form 8-K for Fidelity National Financial, Inc., (Feb. 5, 2009), http://biz.yahoo.com/e/090205/fnf8-k.html.

30. Stempel, *supra* note 15.

31. Press Release, Stewart Title Guaranty Company, Stewart Reports Financial Results for the Fourth Quarter and Year 2008 (Feb. 19, 2009), *available at* http://www.stewart.com/pressRelease/stewart-reports-financial-results-for-the-fourth-quarter-and-year-2008.

32. *See, e.g.*, Haddad, *supra* note 18.

33. Agent defalcation is a term used to describe the agent's illegal conversion of title insurance premiums, recording fees, settlement, or other escrow monies for its own use.

New York, and information has surfaced indicating that one major title company now plans to terminate over 3000 agency relationships nationally in the next year. Another insurer reports it has cut 2500 agency relationships in 2008 alone.[34] While some of these relationships have been cut based on a high ratio of claims to premium dollars, many others have been terminated because of a failure by the agent to meet certain minimum premium remittance amounts. Several local and regional underwriters have stepped in to fill the void and have entered into relationships with some of these agents. However, those agents who were not able to sign-up with a title underwriter have effectively been put out of business.

The impact on the title agent, their employees, families, and clients is profound. With so many title insurers and agents cutting staff, there is simply no place for these people to find work, even though many of these agents have been in the title business and serving a local client base for decades. The impact on the title industry as a whole is arguably worse. Title professionals, those who have long-standing roots in the business and in their local markets, know their local markets, the neighborhoods, the history of the land, and the title to that land, as well as where any potential claims are buried. The loss of these people, many of whom have left the industry, or left the state, in search of jobs or other business ventures, is devastating to the industry. Their knowledge and expertise simply cannot be replaced.

The freeze in the credit markets also caused the near failure of two major title insurers doing business in New York. LandAmerica Financial Group was forced into bankruptcy when it could not sell its auction rate securities in time to meet the obligations of its subsidiary, LandAmerica 1031 Exchange Services, Inc.[35] The bankruptcy filing resulted in the Nebraska Department of Insurance placing Lawyers Title Insurance Company and Commonwealth Land Title Insurance Company into Rehabilitation, until two of Fidelity National Financial's title underwriters—Fidelity National Title and Chicago Title

34. Press Release, Stewart Title Guaranty Company, *supra* note 31.

35. *See, e.g.*, Joseph A. Giannone, *LandAmerica Files for Bankruptcy, Sells Businesses*, REUTERS, Nov. 26, 2008, http://www.reuters.com/article/innovationNews/idUSTRE4AP1W420081126.

Insurance Company—received the approval of the Bankruptcy Court and Federal Trade Commission and purchased the companies on December 22, 2008.[36]

III. Underwriting Impact

The title insurance industry is often misunderstood and has recently been under attack.[37] One concern voiced in some of these attacks is that title insurance premiums are too high based on the percentage of revenue used to pay claims. However, title insurance differs significantly from property and casualty insurance in that most of the energy and costs associated with title insurance premiums are spent in assessing risk and attempting to eliminate those risks prior to issuing a title insurance policy. To that end, title insurers must be vigilant in keeping up-to-date with changing rules, practices, and circumstances—both in lending circles as well as in the law. New legislation, case law, and market conditions involving all aspects of real estate practice and lending practice must constantly be reviewed to determine the impact on title underwriting practice.

When property values first began their decline, the short sale transaction[38] became popular. Short sale transactions pose a particular risk for the title insurance industry in that if

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36. *See* R.J. Lehmann, *Fidelity and LandAmerica Deal Creates Largest U.S. Title Insurer*, BEST'S REV., Jan. 1, 2009.

37. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, TITLE INSURANCE: ACTIONS NEEDED TO IMPROVE OVERSIGHT OF THE TITLE INDUSTRY AND BETTER PROTECT CONSUMERS, GAO-07-401 (Apr. 2007), *available at* http://www.gao.gov/new.items/d07401.pdf; Charles Duhigg, *New York Urged to Tighten Regulations on Title Insurance*, N.Y. TIMES, Nov. 4, 2006, at C2; New York State Insurance Department, Public Hearing on Title Insurance (Nov. 3, 2006), http://www.ins.state.ny.us/hearing/11032006_title_hear/11032006_title_hear_trans.pdf.

38. A "short sale" occurs when the holder of the existing mortgage(s) on the property agrees to satisfy the mortgage upon payment of less than the full payment due under the note(s) secured by the real property. In many cases, the lender will require that the Seller not receive any funds from the sale, or a very small amount. In some instances, the mortgagee will require the borrower to enter into an agreement to repay all or a portion of the outstanding shortage. The title insurer must be certain all the terms of the agreement are complied with.

all the conditions of the short sale agreement are not met, the satisfaction of the mortgage can be withheld by the lender and foreclosure proceedings can either be commenced or continued. More than 35% of all the transactions that closed in the third quarter of 2008 were either foreclosed properties or short sale transactions.[39] There is also a huge potential for fraud in the short sale transaction. Therefore, title insurance companies have instituted underwriting requirements geared toward reducing their exposure under the policy. These requirements necessarily involve the expenditure of additional time and energy in reviewing the specifics of each short sale transaction with a wary eye.

In April 2007, when the first inkling of the impending freeze in the financial markets appeared, title insurance companies geared up and began to send out individual alerts informing their counsel, readers, clearance officers, title closers, and agents that a certain bank or lender appeared to be at risk of not being able to fund any loans that were in the pipeline. These alerts, which varied from company to company, essentially warned that no funds for any transactions, either currently in process or pending, should be disbursed before confirming that wired funds were non-cancellable or that any checks received had unconditionally cleared their escrow or settlement accounts. Most of the alerts also requested that underwriting counsel be informed of any pending transactions involving a certain lender or bank, so that decisions could be made on how to proceed and about whether the intervention of claims counsel might be necessary. At one point, because the sheer number of at-risk lenders was so high, one title company advised its agents that it was nearly impossible to keep up with the flood of failures and directed the agent to a website[40] to confirm that its proposed lender was at-risk prior to insuring any transaction.

On July 26, 2006, the New York State legislature enacted

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39. Walter Molony, *Home Prices Rise in Some Metros, Buyers More Active in Other Areas*, NAT'L ASS'N REALTORS, Nov. 18, 2008, www.realtor.org/press_room/news_releases/2008/11/home_prices_rise_in_some_metro_areas.

40. The Mortgage Lender, Implode-O-Meter, http://ml-implode.com (last visited Sept. 29, 2009).

the Home Equity Theft Prevention Act of 2007 ("HETPA"), which became effective on February 1, 2007.[41] This was the first significant piece of legislation in New York addressing the increase in foreclosure filings. Much has already been written about this legislation, which is intended to protect homeowners from the unscrupulous investors who took advantage of unsophisticated homeowners and stripped the equity in their homes from them under the guise of "helping them stave off foreclosure."[42] Yet, failing to mention it in an essay discussing the impact of the subprime mortgage market on the title industry would amount to a crime of omission. Shortly after enactment, and after a flurry of frantic phone calls between title insurance underwriters, their agents, and members of the real estate bar, there was an equally voluminous flurry of underwriting memos that imposed a host of new exceptions, requirements, and conditions for insuring transactions that involved homeowners whose mortgages or real estate tax liabilities may be in default.

This new legislation initially caused the adjournment of untold numbers of real estate closings in those instances where mortgage payoff letters brought to closings indicated that the borrowers might not be current in their mortgage payments.[43] It also made it nearly impossible for an investor to purchase a home from a homeowner who fell under the protection of the HETPA, without the inclusion of an onerous exception to their title insurance policy. In order to remove the exception, title industry personnel would undergo an extensive review of

41. Home Equity Theft Prevention Act, 2006 N.Y. Laws c. 308, § 3 (codified at N.Y. BANKING LAW § 595-a (McKinney 2009); N.Y. REAL PROP. LAW § 265-a (McKinney 2009); N.Y. REAL PROP. ACTS. LAW § 1303 (McKinney 2009)).

42. *See, e.g.*, Marvin N. Bagwell, *Home Equity Theft Prevention Act: Subprime Crisis May Be Masking Effects of Statute*, N.Y. L.J., Apr. 9, 2008, at 5; Marvin N. Bagwell, *Home Equity Theft Prevention Act: The Title Company's Perspective*, N.Y. L.J., Aug. 13, 2007, at 6; Michael J. Berey, *Home Equity Theft Prevention Act Took Effect Feb. 1*, N.Y. L.J., Mar. 26, 2007, at 4; Bruce J. Bergman, *Home Equity 'Theft': New Law Will Affect Title Insurability, Foreclosure*, N.Y. L.J., Oct. 11, 2006, at 5; Kristen Keefe, *New York Passes Home Equity Theft Protection Act*, LEGAL SERV. J., Aug. 2006, at 17; Thomas Weiss & Kafi J. Harris, *Impact of Home Equity Theft Act on Investors, Lenders*, N.Y. L.J., Nov. 9, 2006, at 4.

43. Marvin N. Bagwell, *The Home Equity Theft Prevention Act: The Title Company's Perspective*, N.Y. L.J., Aug. 13, 2007, at 6.

property appraisals and the real estate contract itself to ensure compliance with the provisions of the HETPA. Before agreeing to omit the exception from the title policy, title insurance personnel would then attempt to gauge the homeowner's level of financial sophistication and contemplate the risk that a borrower might seek to rescind the transaction in the future. Many underwriters simply elected not to insure any transaction falling under the protection of the Act without the exception. Informational and Continuing Legal Education seminars were conducted to advise title personnel and the real estate bar about the new requirements.[44] New affidavits were drafted and new guidelines instituted.[45] Title readers, clearance officers, closers, and underwriters accepted their prescribed role as gatekeepers for homeowners across the state, all without an increase in premium or work charge to compensate them for the additional effort.

Not only must a title insurer make sure that a current transaction complies with the HETPA, she must also carefully review the details of any foreclosure action appearing in the chain of title, either in connection with the current transaction[46] or where a prior, yet relatively recent, foreclosure proceeding appears in the chain of title.[47] One often criticized element of the HETPA is the notice requirement codified as section 1303 of the Real Property Actions and Proceedings Law ("RPAPL").[48] The statute requires that a separate notice accompany the summons and complaint for the foreclosure of mortgages or tax liens on one- to four-family owner-occupied

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44. *See, e.g.*, Complimentary CLE Seminar: Troubleshooting Title and Title Insurance Problems at the New York Marriott at the Brooklyn Bridge (May 14, 2007).

45. See Title Law – New York, Current Developments, http://www.titlelaw-newyork.com/Mans/Current_list.htm (last visited Sept. 29, 2009) for a listing of developments in the New York title industry.

46. Examples of such transactions include sales from a Referee or successful bids in a foreclosure proceeding.

47. In light of the fact that HETPA only took effect on February 1, 2007, coupled with the relatively small volume of transactions involving re-sales, the effect is mostly felt where title insurers are asked to insure a transaction directly from the Referee or successful bidder in the foreclosure proceeding. As time goes on, this will change.

48. N.Y. REAL PROP. ACTS. LAW § 1303 (McKinney 2009).

dwellings.[49] In addition to requiring that the notice be in a certain typeface, the statute also requires that the notice be printed on paper in a color, other than white, that is different from the color of the summons and complaint.[50] No guidance is provided in the statute regarding whether the notice must be included in any court ordered service by publication or whether the published notice, if necessary, must appear in color. From a practical perspective, no title examiner or underwriter will be able to verify what color paper was actually used. Yet, the title insurer will be asked to defend its insured if a foreclosed fee owner challenges compliance with the statute after the sale.

The New York State legislature then enacted a new statute, codified in section 1320 of the RPAPL, which took effect on August 1, 2007.[51] This statute requires that all lenders seeking to foreclose a mortgage covering a one- to three-family residential property first provide a notice in the summons and complaint, in the exact language appearing in the statute, notifying the defendant borrowers that they are in danger of losing their homes and that they must take action to protect their homes.[52] Contemporaneously, section 3215 was added to the Civil Practice Law and Rules ("CPLR"), which requires the lender to mail another copy of this new section 1320 of the RPAPL notice to any defaulting borrower at least twenty days prior to entry of a Judgment of Foreclosure and Sale.[53] As a result of these statutes, more phone calls ensued between underwriters, agents, and members of the real estate bar, along with another round of underwriting memos, exceptions, and affidavits.

Long before the dust settled, more legislation appeared on the scene. New York Legislative Bill 8143-A passed the Senate on June 21, 2008, and was signed into law on August 5, 2008, as Chapter 472 of the Laws of 2008.[54] This legislation not only

49. *Id.*

50. *Id.*

51. 2007 N.Y. Laws ch. 458, § 1 (codified at N.Y. REAL PROP. ACTS. LAW § 1320 (McKinney 2009)).

52. N.Y. REAL PROP. ACTS. LAW § 1320. These actions can include going to court or speaking to an attorney.

53. 2007 N.Y. Laws ch. 458, § 2 (codified at N.Y. C.P.L.R. 3215 (McKinney 2009)).

54. 2008 N.Y. Laws ch. 472.

modified the notices required under sections 1320 and 1304 of the RPAPL, but also added a host of provisions defining high-cost home loans, non-traditional loans, and sub-prime loans, and imposed consumer protection systems designed, once again, to protect the homeowner—this time from predatory lending practices.[55] An amendment to section 1302 of the RPAPL was also included, which requires that any complaint served in a foreclosure proceeding related to a high-cost home loan or a sub-prime loan contain certain affirmative allegations of compliance with all the provisions of sections 595-a, 6-*l*, and 6-m of the Banking Law, as well as compliance with the notice provisions contained in section 1304 of the RPAPL.[56]

The provisions of this legislation again raised concerns from both a title chain underwriting perspective, as well as with regard to any current transactions. First, there was the need to revise underwriting procedures to provide for review of any foreclosure proceedings. Title underwriting counsel, clearance officers, readers, and agents now need to ensure compliance with the new notice requirements and make sure any complaint in any foreclosure proceeding of a high-cost home loan, sub-prime home loan, or non-traditional home loan in the chain of title contains the affirmative allegation required by section 1302 of the RPAPL and that the new notice required by section 1304 of the RPAPL was provided to the borrower ninety days prior to commencement of the foreclosure proceeding. Reviewing a foreclosure proceeding to determine whether the loan being foreclosed was a high-cost, sub-prime, or non-traditional loan is a significant change from prior underwriting practice.

A second major concern was how to deal with those provisions of the law prohibiting negative amortization loans and teaser rates in high-cost home loans and sub-prime loans when asked to issue certain endorsements to the title insurance policy. Generally, a lender will request an endorsement to its title insurance policy whenever its mortgage has a variable rate feature. There are four such endorsements available in New York: (1) Variable Rate Endorsements

55. *Id.*
56. *Id.*

(TIRSA Endorsement 6); (2) TIRSA Variable Rate Mortgage Endorsement – Fixed Rate Conversion; (3) TIRSA Endorsement – Fannie Mae Balloon Mortgage; and (4) Variable Rate Endorsement-Negative Amortization.[57] These endorsements generally ensure the lender that the variable rate features of the mortgage will not result in those mortgages being unenforceable in New York. Of course, therein lay the problem. Since the statute provides that the loan is voidable for non-compliance, concern arose that if the endorsements were issued as currently written and approved by the Department of Insurance, a claim would be filed by the lender against the title policy every time a borrower raised a defense of non-compliance with the terms of the new statute in a foreclosure proceeding.[58] Since title insurance companies are generally not privy to the mortgage application, nor do they generally ever see the mortgage note except in large commercial transactions, a new series of underwriting memos went out to agents, closers, and underwriting personnel cautioning against issuing an endorsement without review of the application and terms of the note whenever any form of variable rate endorsement was requested. Ultimately, a better solution was found and each of the endorsements, as well as the Standard New York endorsement, was amended by TIRSA[59] to include an exclusion from coverage for "any consumer protection law including, without limitation, New York Banking Law Sections 6-*l* ('High-Cost Home Loans') and 6-m ('Subprime Home Loans') relating to a mortgage on land improved or to be improved by a structure or structures

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57. TITLE INS. RATE SERV. ASS'N, TITLE INSURANCE RATE MANUAL, 140, 141, 155, 158 (2008), *available at* http://www.tirsa.org/12-01-08IndexedTIRSARateManual.pdf.

58. *See* N.Y. BANKING LAW § 6-m(3) (McKinney 2009). Both the 1992 ALTA Loan Policy and the 2006 ALTA Loan Policy ensure the enforceability of the mortgage being insured. ALTA, Loan Policy (Oct. 17, 1992), http://www.alta.org/forms/download.cfm?formID=47&type=pdf; ALTA, Loan Policy (June 17, 2006), http://www.alta.org/forms/download.cfm?formID=156&type=word.

59. Title Insurance Rates Service Association, Inc. (TIRSA) is the licensed statistical agent for the New York State Department of Insurance and serves in an advisory capacity only with regard to title insurance rates and forms used by its member companies in New York. *See generally* Title Insurance Rate Services Association, Inc., http:www.tirsa.org/ (last visited Sept. 29, 2009).

intended principally for occupancy by one-to-four families."[60]

In June of 2008, New York's then-Chief Judge Judith S. Kaye announced a new Residential Foreclosure Program geared toward educating homeowners, facilitating early negotiations and settlements, and reducing the 90% borrower default rate in mortgage foreclosure actions.[61] At a news conference announcing the plan, Chief Administrative Judge Ann Pfau expressed concern that the State's 90% default rate may indicate that homeowners do not know that they are losing their homes.[62] Under the plan, the court mails a notice to all parties as soon as the lender files its proof of service of the summons and complaint.[63] The notice advises the parties of the availability of a court conference and provides information to homeowners concerning available legal representation and mortgage counseling services.[64] A provision included in Chapter 472 of the laws of 2008 imposes a ninety-day waiting period before the lender may sue, during which the parties must attempt to resolve their issues.[65] There is also a requirement that the court hold a settlement conference within sixty days of filing for any case filed on or after December 1, 2008.[66] Further, a new section of the Uniform Rules for the New York State Trial Courts requires any lender who commences a foreclosure proceeding on or after September 1, 2008 to file a special Request for Judicial Intervention ("RJI") that includes contact information for the homeowner.[67]

This program, statute, and rule may prove to create a double-edged sword for the title insurance industry. On the

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60. First American Title Insurance Company of New York, Standard New York Endorsement (Loan Policy), Dec. 12, 2008, http://www.firstamny.com/doc/852.pdf.

61. Press Release, New York State Unified Court System, Chief Judge Kaye Announces Residential Foreclosure Program (June 18, 2008), *available at* http://www.courts.state.ny.us/press/pr2008_4.shtml.

62. Mark Fass, *Court Taps Community Resources and Creates Foreclosure Program*, N.Y. L.J., June 19, 2008, at 1.

63. *Id. See also* N.Y. REAL PROP. ACTS. § 1304 (McKinney 2009).

64. Ann Pfau, *Residential Mortgage Foreclosure Program*, N.Y. L.J., Dec. 19, 2008, at col. 1.

65. 2008 N.Y. Laws ch. 472, § 2 (codified at N.Y. REAL PROP. ACTS. § 1304).

66. N.Y. C.P.L.R. 3408(a).

67. N.Y. CT. RULES § 202.12-a (2008).

one hand, it is possible that settling foreclosure proceedings early and keeping families in their homes will reduce lenders' losses, make Wall Street happier, and stem the tsunami of foreclosed homes on the market, thereby helping to stabilize property values, which may in turn spur new transactions and ultimately increase title insurance business. On the other hand, when a borrower raises a defense to a foreclosure proceeding, it becomes much more likely that the lender will look to its title insurance carrier to defend the claim. Many of the defenses raised by the borrower may fall into an "act of the insured" exclusion from coverage under the title policy[68], which will not cost the title insurer more than the cost of processing a denial of coverage letter. However, those defenses that might raise viable claims will, at the very least, involve the payment of defense costs.

In addition, the issue of a lender's standing to bring a foreclosure proceeding started to gain attention in the courts in early 2006. For example, a Suffolk County Supreme Court Judge refused to accept an undated allonge[69] to a note as evidence of the note's ownership, holding that the assignee of the original lender had no standing to bring an action to foreclose the mortgage encumbering the property.[70] This case

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68. Owners and loan title policies in use in New York contain an exclusion from coverage for:

> [d]efects, liens, encumbrances, adverse claims, or other matters (a) created, suffered, assumed, or agreed to by the Insured Claimant; (b) not known to the Company, not recorded in the Public Records at Date of Policy, but Known to the Insured Claimant and not disclosed in writing to the Company by the Insured Claimant prior to the date the Insured Claimant became an insured under [the] policy.

TITLE INS. RATE SERV. ASS'N, TITLE INSURANCE RATE MANUAL 35 (2009), *available at* http://www.tirsa.org/TIRSA_Rate_Manual_081509.pdf. A lender's failure to properly assign the mortgage and note after closing, or to comply with the CPLR in its foreclosure action would fall under the definition of a defect created by the Insured Claimant. See *id.* for sample policies that are authorized for use in New York.

69. An "allonge" is defined as "[a] slip of paper sometimes attached to a negotiable instrument for the purpose of receiving further indorsements when the original paper is filled with indorsements." BLACK'S LAW DICTIONARY 88 (9th ed. 2009).

70. LaSalle Bank Nat'l Ass'n v. Lamy, 824 N.Y.S.2d 769, 2006 WL

was soon followed by several cases challenging standing on the basis of lack of documentary evidence establishing ownership,[71] or lack of authority of the person or entity executing the documents to do so.[72] These courts have also cited the failure of the actual plaintiff to verify the complaint in the proceeding[73] and the failure to follow the CPLR to substitute the plaintiff where there was a post-complaint change in ownership of the lien sought to be foreclosed[74] as reasons for refusing to allow foreclosure proceedings to continue. Today, it is quite common to see similarly decided cases regularly reported.[75]

Further, in just a few short months after the enactment of the Home Equity Theft Prevention Act, a Suffolk County Court denied, without prejudice, a plaintiff's motion for an Order of Reference holding that merely annexing a copy of the notice required under section 1303 of the RPAPL did not provide the court with a sufficient basis to conclude that the plaintiff complied with the statute.[76] One can only assume that the failure to follow the requirements of sections 1302, 1304, 1320 and 3215 of the RPAPL, as discussed above, will lead to similar results.

These cases impact the title insurance industry in several ways. First, title insurers must be hyper-vigilant in insuring any modification or extension of a mortgage, being certain that the chain of ownership of the mortgage and its underlying note is sound. Failure to do so could result in claims under the title

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2251721, at *3 (Sup. Ct. 2006) (unreported disposition).

71. *See, e.g.*, EMC Mortgage Corp. v. Batista, 841 N.Y.S.2d 819, 2007 WL 1599986, at *1, *4 (Sup. Ct. 2007) (unreported disposition).

72. *See, e.g.*, HSBC Bank USA, N.A. v. Yeasmin, 866 N.Y.S.2d 92, 2008 WL 1915130, at *1 (Sup. Ct. 2008) (unreported disposition); *EMC Mortgage Corp.*, 841 N.Y.S.2d at 819.

73. Countrywide Home Loans, Inc. v. Taylor, 843 N.Y.S.2d 495, 496 (Sup. Ct. 2007).

74. Deutsche Bank Nat'l Trust Co. v. Castellanos, 841 N.Y.S.2d 819, 2007 WL 1378059, at *5 (Sup. Ct. 2007) (unreported disposition).

75. Julie Kay, *Judges, Attorneys Work to Stanch Foreclosures*, NAT'L L.J., July 14, 2008, *available at* http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202422931194&slreturn=1&hbxlogin=1. *See also* Mortgage Servicing Fraud, Dismissals Due to Lack of Standing, http://www.msfraud.org/LAW/Lounge/Standing.html (last visited Nov. 20, 2009) (listing recent cases and decisions).

76. *Countrywide Home Loans, Inc.*, 843 N.Y.S.2d at 497.

policy if any of the assignments made prior to issuance of the title policy are challenged during the course of the foreclosure proceeding. Second, title insurers must review the details of any completed foreclosure proceeding, particularly when insuring title out of the Referee or the successful bidder in such foreclosure action, to ensure compliance with provisions of the existing laws and rules of civil procedure, as well as all these new statutes. With almost 45% of all current transactions involving distressed properties,[77] title professionals must spend significantly more time reviewing each file and they must be more diligent in their underwriting practices.

IV. Conclusion

The sub-prime mortgage crisis and the resulting economic devastation have significantly damaged the title insurance industry. Title insurance companies are posting massive losses as they deal with the combination of declining revenues from the reduction in title orders and the burgeoning number of claims. In an attempt to cut expenses, title companies have eliminated close to 50% of their staff and closed hundreds of offices.

Insurers have also terminated thousands of underwriting agreements with title agents in an effort to reduce the number and extent of claims. These decisions, however, fail to recognize the value that an independent title agent brings to the industry and will therefore result in the loss of much local historical knowledge and expertise. Much of that historical knowledge and expertise will not be recoverable when business improves.

The industry is also significantly strained as it attempts to process thousands of claims; implement more stringent underwriting standards; and review and respond to new legislation, case law, and court processes, all with huge reductions in staff.

While only time will tell if this era will ever officially be

77. Walter Molony, *4th Quarter Metro Area Home Prices Down as Buyers Purchase Distressed Property*, NAT'L ASS'N REALTORS, Feb. 12, 2009, http://www.realtor.org/press_room/news_releases/2009/02/4th_quarter_metro_area_home_prices_down.

classified as a financial depression, or if it will remain labeled a major recession, it is readily apparent that the extent of the damage is far-reaching and has been devastating to the title insurance industry as a whole.