Even as We Speak:
Today's (Magnificent) Seven Underwriting Topics
Conestoga Title Insurance Co.

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60 min. total

I. Sovereign Citizen Filings (10 min.)

A. The Standard: The Clerk will record anything or be shot
B. The Unusual: Just file a UCC financing statement (because you can)

II. Extraordinary Commercial Endorsements Reappear (15 min.)

A. The Swap
B. The Future Advance
C. The Same as Survey
D. The Mineral Rights Series
E. The Reverse Mortgage on a Purchase (not commercial but still extraordinary)

III. Leaseholds and Ground Rents (5 min.)

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V. Affirmative Coverages (10 min.)

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B. Matters in Litigation
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D. 'Insuring Around' or 'Insuring Over'

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I. Sovereign Citizen Filings

Materials for Topics A and B will be found in the attached Appendix. For a general review of this subject, please see "'Sovereign Citizens' Plaster Courts with Bogus Legal Filings – And Some Turn to Violence," *ABA Journal*, Vol. 100, May 2014, pp. 52-58. [http://www.abajournal.com/magazine/article/sovereign_citizens_plaster_courts_with_bogus_legal_filings]

A. The Standard: The Clerk will record anything or be shot

B. The Unusual: Just file a UCC financing statement (because you can)

II. Extraordinary Commercial Endorsements Reappear

A. The Swap

As commercial mortgage interest rates begin to move up again, Swap endorsements may be seen in more transactions, particularly as long as European financial institutions continue to have lower market rates. The basic concept is the provision in current mortgage instruments to allow the borrower to exchange interest rates in the future from the present lender's variable rate to a rate available from another lender. The ability to do so is contained in an ISDA (International Swap and Derivatives Association) Agreement, which must be part of your submitted documentation for review by the title underwriter.

The ALTA 29-06 (Interest rate swap – Direct obligation) [TIRBOP 1320] and ALTA 29.1-06 (Interest rate swap – Additional interest) [TIRBOP 1330] are the endorsements you will be requested to issue most often. Both will require approval from your underwriter. The endorsements insure against invalidity or unenforceability of the mortgage as security for the repayment of the swap agreement and against loss of priority of the insured mortgage as security for the repayment. The endorsements do not advance the Date of Policy to the date of actual exercise of the swap nor do they insure that the amount of loss of interest can be calculated, which is a damages matter.

B. The Future Advance

Similar to the ALTA 6 (Variable rate mortgage) series, the ALTA 14 series endorsements insure against lack of priority, invalidity or unenforceability of the mortgage as a result of provisions for future advances of principal or interest in, usually, a commercial setting. The ALTA 14.2-06 particularly addresses a situation in which a letter of credit is additional collateral secured by the land. The ALTA 14.3-06 (Future advance – Reverse mortgage) is discussed below.

C. The Same as Survey

Pennsylvania does not have a form endorsement styled ‘Same as survey’ but the ALTA 22-06 (Location) seems to satisfy a lender’s request for same. The endorsement merely states that the land shown on the survey is located at the address given in the mortgage. What is lacking in most circumstances is a survey; consequently, the use of the endorsement may be moot. New York actually has a TIRSA endorsement styled ‘Land same as survey,’ but the usual procedure of ‘reading the legal description’ makes the survey a necessary part of the insurance process.

D. The Mineral Rights Series

Random thoughts on applicability of title insurance coverage when an oil and gas lease is discovered in the chain of title:

1. Title underwriters may take different approaches to using ALTA 9-06 (TIRBOP 1030) and ALTA 35-06 (TIRBOP 1341). Always check with the underwriter to be sure what is said here applies to it. These comments are indicative only of Conestoga Title’s underwriting on these title issues.

2. Coverage against losses resulting from oil and gas leases (and other subsurface mineral rights) is more readily available in residential transactions than in commercial situations. Obtaining coverage by use of either of the endorsements in a commercial transaction will probably require greater than normal title examination work and additional underwriting by the insurer’s staff.

3. Coal clauses are mandated by statute for inclusion in deeds in most Pennsylvania counties (not Lancaster, though). Title underwriters generally include similar language as a standard, nonwaivable Exception (Schedule B) in a title policy. In counties in which active oil and gas leasing is occurring or active drilling has been observed for years, a similar Exception will probably be included in title policies.

4. The Exceptions noted in Item 3 above will occur in policies even if there is no reported lease, royalty agreement, drilling rights, severance for exploration, etc. among the land records. This is because such matters may not be uncovered in a reasonable title search of sixty years, but the history of mineral exploration and drilling in the county has been known off record.

5. If a title search reveals a recorded oil and gas lease in the title chain it will be specifically excepted from coverage (Schedule B). Language contained in the instrument, statute, evidence of abandonment, etc. may indicate that the lease is not continuing. The fact that it is of record and not terminated by an instrument also recorded will be enough to have the Exception as to it retained in the title policy.

6. ALTA 9-06 and ALTA 35-06 serve to provide affirmative coverage against the Exceptions to title stated in Schedule B. If there is no Exception, but there is, in fact,

leases of record, then losses may be payable under the title policy in accordance with other provisions of the title policy.

7. The language of the ALTA 35-06 (Mineral and other subsurface substances – Buildings) generally follows that of ¶¶ 4.c.ii., 5.d., and 5.e. of the ALTA 9-06 (Restrictions, encroachments, minerals). The ALTA 35-06 is applicable to subsurface mineral rights whenever they present a title issue. The ALTA 9-06 responds to other title issues than subsurface rights and drilling rights.

8. As a consequence of the statements in Item 7, if the lender requests coverage against losses from drilling for oil and gas, the preference of this underwriter is to issue the ALTA 35-06 only without the ALTA 9-06. If the lender wants coverage of other matters, a choice of another endorsement will be made. For example, the ALTA 9.3-06 is applicable to restrictions only and the ALTA 28 series in general deals with survey matters.

9. The affirmative coverage language neither protects against oil and gas leases of record nor against exercise of the rights contained in such leases. It protects against damage to Improvements on the Land by exercise of the rights reserved to the lessee. Consequently, a Conestoga underwriter will be reviewing the lease to determine the limitations upon use of the surface of the insured Land by the lessee. If there are provisions in the lease for the lessee to restore the property after drilling or mining or obligations to drill or explore closer than 200 feet of any existing improvements owned by the lessor, the coverage will probably be issued.

10. The presence of a drill in a residential subdivision does not mean that the ALTA 9-06 or ALTA 35-06 will not be issued. The coverage is applicable only to the exercise of future rights to extract subsurface minerals. Damage existing at the date of policy is not covered.

11. Drilling for subsurface minerals elsewhere than on the insured Land (as part of a unitized lease that is excepted in Schedule B) may result in damage to Improvements on the Land, from fracking, for instance. Such damage is excluded from coverage by ¶ 5 of the ALTA 9-06 (¶ 4 of the ALTA 35-06). See sub-parts d. and e.

12. The Exceptions noted in Item 3 above will occur in policies even if there is no reported lease, royalty agreement, drilling rights, severance for exploration, etc. among the land records. This is because such matters may not be uncovered in a reasonable title search of sixty years, but the history of mineral exploration and drilling in the county has been known off record.

13. If a title search reveals a recorded oil and gas lease in the title chain it will be specifically excepted from coverage (Schedule B). Language contained in the instrument, statute, evidence of abandonment, etc. may indicate that the lease is not continuing. The fact that it is of record and not terminated by an instrument also recorded will be enough to have the Exception as to it retained in the title policy.

14. ALTA 9-06 and ALTA 35-06 serve to provide affirmative coverage against the Exceptions to title stated in Schedule B. If there is no Exception, but there is, in fact, leases of record, then losses may be payable under the title policy in accordance with other provisions of the title policy.

15. The language of the ALTA 35-06 (Mineral and other subsurface substances – Buildings) generally follows that of ¶¶ 4.c.ii., 5.d., and 5.e. of the ALTA 9-06 (Restrictions, encroachments, minerals). The ALTA 35-06 is applicable to subsurface mineral rights whenever they present a title issue. The ALTA 9-06 responds to other title issues than subsurface rights and drilling rights.

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18. The presence of a drill in a residential subdivision does not mean that the ALTA 9-06 or ALTA 35-06 will not be issued. The coverage is applicable only to the exercise of future rights to extract subsurface minerals. Damage existing at the date of policy is not covered.

19. Drilling for subsurface minerals elsewhere than on the insured Land (as part of a unitized lease that is excepted in Schedule B) may result in damage to Improvements on the Land, from fracking, for instance. Such damage is excluded from coverage by ¶ 5 of the ALTA 9-06 (¶ 4 of the ALTA 35-06). See sub-parts d. and e.

E. The Reverse Mortgage on a Purchase (Not commercial but extraordinary)

The ALTA 14.3-06 (Future advance – Reverse mortgage) endorsement is only used for residential transactions. Usually there will be two mortgages, one for the lender and the second in favor of HUD who will be issuing government-backed mortgage insurance for the loan. At least one borrower has to be over the age of sixty-two. The traditional reverse mortgage is a lending scenario designed to free senior citizens from mortgage payments by using large equity in the residence as an annuity for the rest of life.

While many title agents have seen the traditional reverse mortgage, new home builders are attracting senior citizens with a plan that utilizes the large equity in their existing homes as creating equity in their new homes being built. The problem with this type of transaction is that the equity does not exist in the property providing the security. The concept is viable, however, and you should be alert to a request to issue a reverse mortgage endorsement in this case.

III. Leaseholds and Ground Rents

This is just a caveat to alert you to a troubling matter that has been revealed in a couple of title searches this past year as to leasehold estates. Some mobile home parks are marketing the available units as being subject to a ground lease of the land on which the mobile home sits. A search of the title shows no ground lease (and possibly not even a subdivision of an acreage piece into separate lots upon which a particular mobile home sits). Insuring such a transaction on either a fee owner's policy or a leasehold owner's policy is dicey at best. Most likely it is uninsurable either way.

IV. Insuring Localities

While not a common occurrence, nothing prevents a locality from obtaining a title insurance policy. You need to identify those particular state statutes that permit the locality to acquire real estate and for what purposes. Then the locality needs to follow the correct procedures to complete the transaction. Note that development authorities and similar agencies are often state created corporations. As such, requirements that you include for a non-public corporation should suffice for the public or quasi-public corporations.

V. Affirmative Coverages

Examples of language sometimes used for affirmative coverage follow. Remember that affirmative coverage is intended to address specifically a matter that has been removed from policy coverage, for example, an encroachment that is shown by a survey and thereupon creates a title defect.

Divestiture of lien of the insured mortgage:

This policy insures against loss or damage which the mortgagee might sustain by reason of any **court order which constitutes a final determination that divests the lien of the insured mortgage** from the insured Land as a result of the encroachment by the existing chain link fence into the right-of-way of Crandell Road as shown on the survey of the Land dated 3/10/2013.

Enforcement or attempted enforcement with a commitment to defend and extend similar coverage in the future:

Commonwealth of Pennsylvania Department of Revenue v. Alpha Bank, filed November 1, 2012, in York County, Pennsylvania, to 2012-NO-xxxx-yy, in the amount of $ 1,500.99 plus interest and penalty. ("Excepted Item")

Subject to the Conditions contained in the policy and the Exclusions from Coverage contained in the policy, the Company hereby insures the Insured against actual loss or damage which the Insured might sustain **by reason of any enforcement or attempted enforcement** of the above matter that is adverse to the estate or interest of the Insured described in Schedule A hereof. The insurance provided Insured as to this matter **includes the duty to defend the Insured**, subject, however, to the Insured's obligation to provide notice and cooperate in the defense as provided in the Conditions contained in the policy. The insurance provided Insured as to this matter **does not obligate the Company to remove the Excepted Item** from the public records constituting constructive notice. The Company **will extend insurance similar** to that stated here to Insured's subsequent lender(s), purchaser(s) or purchaser(s)'s lender(s), subject to ordinary underwriting requirements applicable at such subsequent event(s).

Comfort language:

The Company will not deny coverage under the policy to the Insured, including under Exclusion from Coverage No.3 as to knowledge of the Insured, as to the matter excepted herein, to-wit: The legal description of the Land has inverted numbers in the distance measurement for the western side lot line of the Land.

A. Encroachments

Existing improvements can encroach across boundary lines, setback lines, or into easement areas. Candidly, permanent improvements – not fences or sheds – should be the item doing the encroaching before considering affirmative. That is, non-permanent items that are not fixtures to land should not be covered by affirmative language as that extends title insurance into unintended matters. Nevertheless, such may be done to preserve a deal if the risk is minimal. Actual denomination of an encroachment by a surveyor should always be excepted from coverage in order to avoid misunderstanding by the Insured. *De minimis* encroachments, particularly those by movable objects, should be ignored as they are not truly defects to the title. Note that the ALTA 9 endorsement series or ALTA 28 endorsement series are usually just as effective as specific affirmative coverage as to encroachments.

B. Matters in Litigation

Always check with your underwriter when the current property owner is involved in litigation. If a homestead deed is filed, be sure to check for a bankruptcy proceeding.

C. Old Mortgages

We receive many questions about providing title insurance and insuring over the recorded but unreleased "ancient mortgage." Answering this question really comes down to state by state and case by case review.

<u>Pennsylvania Title Insurance</u>

When issuing title insurance in Pennsylvania, note that the Commonwealth does not have a specific statute that addresses the assumption of a payment on an "ancient mortgage." We must handle this on a case by case basis. However our Underwriting Guidelines call for the agent to ascertain the final payment date of the mortgage in question and whether there has been any activity for a period of 21 years after the final due date.

Maryland Title Insurance

Maryland has a statute directly on this point: Maryland Code §7–106.

(c) (1) If a mortgage or deed of trust remains unreleased of record, the mortgagor or grantor or any interested party is entitled to a presumption that it has been paid if:

(i) 12 years have elapsed since the last payment date called for in the instrument or the maturity date as set forth in the instrument or any amendment or modification to the instrument and no continuation statement has been filed;

(ii) The last payment date or maturity date cannot be ascertained from the record, 40 years have elapsed since the date of record of the instrument, and no continuation statement has been filed; or

(iii) One or more continuation statements relating to the instrument have been recorded and 12 years have elapsed since the recordation of the last continuation statement.

(2) Except as otherwise provided by law, if an action has not been brought to enforce the lien of a mortgage or deed of trust within the time provided in paragraph (1) of this subsection and, notwithstanding any other right or remedy available either at law or equity, the lien created by the mortgage or deed of trust shall terminate, no longer be enforceable against the property, and shall be extinguished as a lien against the property.

(3) (i) A continuation statement may be filed within 1 year before the expiration of the applicable time period under paragraph (1) of this subsection.

Caveat: When the borrower on the mortgage in question is a prior owner, the best practice is to obtain a copy of the current owner's policy to determine if the mortgage may be omitted under the inter-underwriter indemnification treaty (New York and New Jersey) or, in the alternative, pursuant to a letter of indemnity from the present owner's underwriter. Underwriting will need to see some proof of payment and will most likely demand that we utilize a release tracking company in order to obtain some form of release from the prior creditor.

D. 'Insuring Around' or 'Insuring Over'

While this will be a matter for discussion at the seminar, note that the important point is always disclose the issue and disclose in writing if possible.

VI. Closing Table Issues

A. Disclosures

Adopted in January 2014 and effective for loans applied for on and after August 1, 2015, the CFPB's TILA-RESPA Integrated Mortgage Disclosures Rule ("the Rule") includes numerous compliance issues for title companies and closers of consumer mortgage loans. Among these issues are the revised loan estimate and final closing disclosure forms, how to disclose optional charges (particularly owner's title insurance), and who is responsible for the content of the Rule's forms. This article focuses on another key sub-rule, the requirement for three days advance delivery of the final closing disclosure prior to 'loan consummation.' (There is also a three day rule applicable to the loan estimate but compliance with it does not impact settlement service providers.)

The first issue to resolve is responsibility for delivery of the closing disclosure ("CD") to the consumer which is not the same issue as responsibility for its content. (The latter may be shared between lender and settlement service provider.) The Rule is clear that the creditor (*nee* lender) must deliver the CD to the consumer at least three days in advance of closing. A settlement service provider may undertake this task on behalf of the lender, but, in so doing, assumes a liability that it does not have under the Rule. The lender must still make sure that the provider complies with the Rule's timeframes. 12 C.F.R. § 1026.19(f)(1)(v). [Note that most Code of Federal Regulations cited here are not effective until August 1, 2015, including this one.] This would be another issue of lender oversight of your compliance with regulations for which it has responsibility. If you undertake the delivery of the CD, be sure that your *Best Practices*-compliant policies and procedures manual documents how you will perform this task.

The delivery of the CD must occur at least three *business* days ahead of closing. That is three calendar days (not 72 hours) in which the creditor is routinely open for business. This is different than the TILA rescission rule which counted Saturday automatically. Under the Rule, it is reasonable to exclude Saturday from any three day calculation, and, of course, Sundays and Federal holidays are excluded (even if the creditor is open). [Note that some state holidays would also be excluded if the creditor closes its offices on those days.]

The rule treats delivery as an actual event. That is, delivery is effected when the CD is placed in the hands of the consumer/borrower in fact. This is stated in reverse language: "If any disclosures required under paragraph (f)(1)(i) of this section are not provided to the consumer in person, the consumer is considered to have received the disclosures three business days after they are delivered or placed in the mail." 12 C.F.R. § 1026.19(f)(1)(iii). In other words, if the CD is sent by regular mail, add three days to the requisite time required by the Rule. Deemed delivery and receipt (three days after mailing) must precede the loan consummation by three days. That means six business days before closing are needed for disclosures sent by mail. Proof of delivery is not necessary but having such will defeat a claim of non-compliance with the rule. Not clear from the rule but probably true is that actual delivery, acknowledged by the consumer's signature to a delivery receipt even through the mail, will begin the three day clock at the time of acceptance of delivery even if the mailed item sub-rule would have been in effect. [Note that electronic forms of delivery may be used essentially providing instantaneous delivery. The big caveat here is that the consumer must agree to such delivery in advance, provide an e-mail address, and provide other affirmations under law other than the rule itself. Should there not be consumer acceptance of electronic delivery, then such delivery works just like the use of the mail system. 12 C.F.R. § 1026.17(a).]

If something changes going into the closing that affects the CD already delivered, there may have to be re-disclosure. If so, the three days delivery sub-rule is fully back in play. However, most of the old-day tolerances/variances are matters that affect the lender's initial loan estimate and it has to be revised and redisclosed. Permitted variances may be corrected at closing. These three items, however, due require a revised CD and a new three day delivery period: (1) The annual percentage rate becomes "inaccurate" (varies by more than one-eighth of a percentage point from original calculation, § 1026.22(a)); (2) The loan product changes (e.g., the loan changes from variable to fixed rate); or (3) A prepayment penalty is added. 12 C.F.R. §1026.17(f)(2)(ii). [Note that these three items would generally be included among the original CFPB disfavored loan terms with the original 'Know Before You Owe' program.]

B. Closing Protection Letters

In December 2015, the American Land Title Association promulgated two new forms of closing protection letter and advocated their use by the industry in connection with the issuance of title insurance and settlement of real transactions in which CPL service was to be used. Below are a few random comments on the use of the closing protection letter intended for a single property/transaction.

1. There is a companion new CPL for multiple transactions, a so-called 'umbrella CPL.' Its use is not favored, but its language does not vary much from the single transaction letter being discussed.

2. The new CPL is longer being almost double in length of the letter previously used until about July 1, 2016.

3. Although longer, substantively, not much has changed.

4. The new letter looks more like a title insurance policy. Indeed, the definitions and much of the language employed were taken from the 2006 ALTA policy forms in current use in the industry.

5. The transaction identifying language at the heading of the letter should be duplicated in the title commitment so as to isolate the CPL to a particular real estate transaction more readily.

6. The 'covered risk' of the CPL is stated in Requirement 4. The language is essentially the same as before but has been rewritten. The same is true for Requirement 2.

7. Requirement 1 makes clear something that was always understood to be true in the past: There is no coverage under a CPL unless a title insurance policy has been issued and/or the insurer is obligated to issue a policy. The latter would only occur if a commitment/binder has been issued and all of its requirements have been met. In other words, issuance of a commitment alone would not bind the company under the CPL.

8. Requirement 3 is a new idea. Although probably insignificant in the long-term, the provision that limits losses under the CPL to the actual amount transmitted to the closing agent means that the insurer is only liable for the net funds sent to the closer and not for the policy amount.

9. The Conditions and Exclusions ("C&E") have been expanded. Among other new items, you will find a series of definitions (C&E 2). Note that a plain language approach is intended (C&E 2.(d)). There is an intention to parallel definitions in the CPL with those of the 2006 ALTA policy forms. Specifically included among the covered persons under the CPL are an assignee of a lender and the warehouse lender funding the transaction.

10. The laundry list of exclusions from coverage is broadened in C&E 3. While many of the exclusions are carry overs from the former CPL, there is greater emphasis on consumer protection laws and mechanic's lien/construction loan programs. Also, there is a new exclusion for 1031 exchanges.

11. Much of the content of C&E is defining the claims process. There is intent to have the process follow that which is provided in the ALTA 2006 policy forms. See C&E 5, 6, 7, 8, 12, and 13.

12. Paragraph C&E 9 is new. This provision restates that which was already believed to be true that the closer is not an agent for the insurer in and about the conduct of real estate closings. Losses are limited to matters that are stated in the letter. In other words, negligence in the closing process unrelated to the issuance of title insurance or compliance with lender instructions that relate to title (for example, legal advice that is inaccurate) is not covered.

13. Paragraph C&E 10 clearly states that a claim must be made within one year of transmission of funds as contemplated by the letter (and its contemporaneous title commitment). As the CPL is a filed form with Commonwealth insurance regulators, it is less likely that this provision will be removed or amended in connection with a single real estate transaction. In other words, lender demands for a longer term will probably not be successful. Also note the new second sentence. A claim under a CPL that is first made more than one year after disbursement cannot be resurrected by the claimant stating that the insurer is not prejudiced by the late notice. Even if the insurer is not prejudiced, the claim is limited by the one year term.

14. On the other hand, even a claim made within the one year may be subject to denial by the insurer if the insurer is prejudiced by the tardiness of a claim.

15. An arbitration provision is retained from the former CPL. See C&E 15.

C. CD vs. HUD1 vs. ALTA Settlement Statement

This matter may be discussed at the seminar but it will surely be a topic for the Best Practices update session.

VIII. Your Questions/Our Best Answers