



December 3, 2012

FEDERAL EXPRESS

Hon. Bruce R. Ramge
Chairman
Title Insurance Task Force
National Association of Insurance Commissioners
NAIC Executive Office
444 North Capitol Street NW
Suite 701
Washington DC 20001

Dear Mr. Ramge,

Please accept this letter opinion in support of the Title and Escrow Theft and Insurance Fraud Whitepaper being developed by the NAIC and the working groups under your Task Force seeking a solution to better risk management and insurance protection for losses from title and escrow fraud.

I have been an attorney in the mortgage and finance industry for more than 25 years, having served as in house counsel to mortgage lenders, as well as an outside attorney and consultant to a number of large retail and mortgage banks on regulatory, compliance and mortgage fraud matters. I have previously written numerous articles for industry publications such as National Mortgage News, National Mortgage Professional, and the Credit Union Times specifically addressing insured closing letters and greater closing table risk management. I have also been a platform speaker at MBA sponsored conferences on risk management, most recently in Dallas in July 2012. A copy of the supporting materials for my July 2012 presentation on closing agent risk in the age of the CFPB is attached for your information and is available on the MBA website.

For the past ten years I have researched and studied the issue of risk management surrounding the mortgage closing transaction. My efforts involved reviewing hundreds of forms of closing protection letters, analyzing hundreds of agent defalcations, testifying on behalf of law

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enforcement in criminal actions, in attorney disciplinary hearings, and in civil litigation involving mortgage fraud. I have also have spent the past four years, beginning in 2008, meeting with warehouse banks, mortgage lenders, title agents, and major title underwriters to discuss alternatives to the CPL and ways to combat the growing problem of escrow and closing fraud. These discussions included an exchange of data related to losses, the cause of losses, and the varying ways to address losses to reduce costs and protect consumers from harm. While we have not always agreed on the methods I advocated, everyone I spoke to agreed that the closing process needs greater risk management.

Need for Supervised Professional Standards and Monitored Best Practices

For years now the mortgage and real estate closing process has been largely viewed by some banks and settlement professionals as nothing more than a glorified signing party. Concerns about fraud, infidelity and negligence on the part of those handling mortgage proceeds and bank documents and the other professionals who play a part setting a transaction have been largely ignored. This has been true despite the fact that the concept of wiring funds to a closing agent who is largely unknown and allowing strangers to handle mortgage documents and disbursements without uniform standards seems counter to prudent business practices.

Today title underwriters, who have been primarily self-insured, have seen claims rise, profits dwindle, and lawsuits by lenders and consumers stack up at courthouses around the Country. Billions of dollars in damages from mortgage fraud have created a firestorm that the title industry simply cannot extinguish. Consequently, any notion that title underwriters can continue to allow agents to bind them for acts of negligence and infidelity by closing agents requires radical readjustments and new thinking. Likewise mortgage lenders and consumers cannot continue to rely upon the closing protection letter as a form of insurance against losses from mortgage fraud when it is not an insurance product and offers very limited coverage for losses. Quite frankly it is time for the title companies and their issuing agents to get out of the property and casualty/fidelity insurance business and for lenders to utilize third party sources for underwriting and insuring risks at the closing table.

It's All In the Numbers

Anyone connected to the mortgage and real estate industries is familiar with the numbers, but they are worth a reminder. The FBI has called mortgage fraud the number one white collar crime in America, and after terrorism, has allocated more agents nationwide to investigating and fighting the crime than any other. In 2011 the Agency reported \$11 billion in mortgage

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fraud losses from SARS filings, and for 2012 the number is estimated to rise to \$13 billion. The FBI estimates that 15% of those losses are directly attributable to escrow and closing fraud. These figures appear to be supported by the Financial Crimes Enforcement Network (FINCen) July 2012 study of SARS reports between 2003-2011 which indicated that there has been unacceptable growth in fraud losses in the escrow and closing area, with a 20% increase in the most recent period. So this year we will see close to \$2 billion in losses, most if not all will eventually be passed along to the consumer.

According to statistics published by the National Association of Realtors and Mortgage Bankers Association, there are 8.5 million mortgage closing transactions annually, with the average loan size approximately \$175,000.00. Each of these loan transactions require a closing attended by a settlement agent, so that means that in 2012 lenders will have delivered more nearly \$1.5 trillion dollars (and the collateral security documents to establish their legal right to repayment) into the hands of men and women whom, for the most part, they met for the first time a few days before a closing.

Fraud at the Closing Table

While fraud can take place in any part of the loan process, lenders are most at risk at the closing. Settlement agents, who are responsible to disburse the lender's money, to supervise the execution and delivery of the deed, note and mortgage instruments, are traditionally subject to little or no scrutiny. Licensing, while important as a bar to entry into a profession, is not risk management. Anyway there is no one license that covers all of the various actors who can handle funds and documents at a closing, which depending upon the state or region includes lawyers, escrow agents, title agents, mobile notaries, closers and realtors. The little vetting that does occur, by title underwriters and some banks, is primarily static and not ongoing, is not uniform, is generally focused on entities, and involves no sharing of data. In addition one need only review the FBI fraud statistics, as well as the latest entries in the Mortgage Fraud Blog to realize that whatever is being done now, is not working.

Agents are still stealing funds, aiding fraud at closing and looking the other way. Common recent incidents reported publicly have included instances when an agent documented non-existent buyer cash to close, permitted same day property flips, and when funds were accepted or disbursed to or from third parties not identified to the lender as formally connected to the transaction.

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Theft of funds and outright fraud are a serious problem, but there are other ways that unsupervised, unmanaged, and non-vetted agents can cause havoc.

It's Not Just Fraud and Escrow Theft

Settlement agents can also act negligently, by failing to obtain the properly signed note, or to record the mortgage, thereby creating significant liability for lenders. Since settlement agents, including lawyers, are not uniformly required to carry liability insurance or fidelity bonds, and there is no standardized process in place to verify insurance coverage when a party to the closing does require it, lenders and consumers can have no faith they will recover their losses resulting from negligence or bad acts by settlement agents at closings. In the past lenders have taken the risk associated with the unregulated and unsupervised nature of the closing process because losses from fraud at closing had historically been a small percentage of overall mortgage fraud damages. That is why most lenders focused whatever spending they could allocate to fraud deterrence on front end fraud software, such as social security number verification, automated appraisal reviews and similar products. According to the National Mortgage Bankers Association, lenders spent approximately \$1 Billion on fraud deterrent software to use in the origination and underwriting process in 2011. The amount reported to address fraud and negligence at closing is not even on anyone's radar.

The Inadequacies of the Closing Protection Letter

Other than faith in law enforcement, what can a lender do to reduce the risk of loss due to fraud or negligence at a closing? Each day when lenders wire millions of dollars into the trust accounts of attorneys and non-attorney settlements agents they have historically relied on the closing protection letter (in some states known as the insured closing letter) issued by title underwriters, through their agents, to seek recovery for their losses. These letters though provide no relief when a settlement agent engages intentional acts other than outright theft of funds, or when an agent's negligence fails to rise to a non-curable cloud on title. Unrecorded mortgage?, the letter provides coverage against intervening liens. Fraudulently recording cash to close on the HUD-1 in a straw buyer, fraud for profit scheme? As long as you can still foreclose, no coverage and no claim for lost interest or principal payments on the loan, cost of foreclosure, cost of repurchases (i.e. premium recapture), etc. In the State of California, case law even supports the proposition that a closing agent has no legal or contractual obligation to report fraud at the closing even when the agent may personally witness suspicious or even fraudulent activity taking place(1) In 1999, in *Voumas v. Fidelity National Title Co.*, the California Court of Appeals held that settlement agents have "no duty to police the affairs of a

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lender,” and have no obligation to “report fraud.” Similar results were reached in the California decisions found in *Axley v. Transational Title Ins. Co.* and *Lee v. Title Ins & Trust Co.*

In reality a closing protection letter looks and smells like an insurance product, and today is charged to the borrower like one, but in fact is not insurance. Nor is it assurance against mortgage fraud at the closing table, and lenders are foolish to rely on them except as they apply to the lien priority of their loan. Furthermore, there is no national standard for issuing closing protection letters, which are typically issued by title agents and who, because of business relationship with settlement attorneys and others, have a conflict of interest in evaluating their credentials. As a result, lenders have had no real comfort in the existence of these letters as a method of evaluating the experience, trustworthiness, and reliability of the agents who will handle their funds and documents at a closing. Similar, most lenders have had no standard policy for reviewing and verifying CPLs, not just for their validity (i.e. were they properly issued), but also to verify the credentials of whomever the letters named as agent.

Fannie Mae’s Recommendations Were Ignored; Now CFPB Has Issued a Mandate

Fannie Mae’s December 2005 Newsletter on “Preventing, Detecting & Reporting Mortgage Fraud” states in part that “mortgage lenders must know {their} business partners & and consider using outside sources to and selectivity choose closing attorneys and settlement agents.” These guidelines, which mirror ones issued by the OCC for supervised banks in 2001, were issued many years ago, yet until April 2012 there were very few lenders who were following this sound advice.

Of course in April 2012, the Consumer Financial Protection Bureau issued Bulletin 2012-3 which appears to mandate that non-bank entities, mortgage lenders and brokers, take affirmative steps to adopt adequate risk management policies to prevent consumer harm from third party service providers. Some see ambiguity in its directive, I see it as merely extending existing requirements for supervised banks to non-bank entities that have been in place for years.

Today, lenders for the most part have no comprehensive program to assess the risk of settlements agents, and no one from the national or state bar associations, notary association, or title agents association have stepped forward with uniform standards, guidelines or requirements for certifying the qualifications of the people who control the loan documents and mortgage funds at closing nationwide. Recently ALTA has published “Best Practices,” yet that organization has no ability to monitor or enforce these voluntary standards. More

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importantly any organization that exists on membership dues cannot truly police its members, let alone turn them over to law enforcement and report them publicly for bad acts. In fact, instead of embracing change in this area, some industry associations have decided to attack the messenger, or seek “exemptions” from compliance claiming that either “there is no problem,” or that “we are regulated enough.” Unfortunately the escrow and closing fraud loss figures don’t support either position.

Without a new method of vetting, monitoring and evaluating the risk of settlement agents, and properly insuring them for both fraud and negligence at closing, it is foolhardy for lenders to continue to rely on the current closing protection letter as security for the proper coordination and execution of the mortgage loan closing process.

A Solution: Certification & Uniform Standards

One solution that has emerged, and I have advocated for the past ten years is to take the vetting process away from lenders, title underwriters and their agents. Instead it calls for independent third parties to perform independent scrutiny and verification of settlement agent identity and credentials.

Lenders control closing funds so they have every right to establish reasonable criteria for making funds available at closing by requiring settlement agents to meet certain minimum levels of experience, insurance and overall risk. Shining a light on the closing process, and those who work in it, can go a long way toward weeding out the bad operators. It also helps define a better process for the honest and orderly execution and recording of loan documents, as well as the proper and ethical management of mortgage loan funds.

Title underwriters, who are under siege from lawsuits attempting to validate claims for losses under the closing protection letter, need someone without a claims legacy to replace the current self-insured environment with a sensible product that combines fidelity and negligence coverage in one package. Title underwriters and their agents need to get out of the business of insuring the acts and omissions of settlements agents as they have allowed the closing process to be subject to unacceptable risk for far too long. Lenders who never read their closing protection letters until the past two years would welcome real protection from closing fraud backed by standards that give some comfort whenever the lender wired funds to a closing table.

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Settlement agents, including real estate closing attorneys, must wake up and realize that the closing process is not one left to last minute preparation, or to be entrusted to paralegals and legal securities. The Bar has already seen disciplinary decisions holding lawyers responsible for everything that transpires at a closing, and to be diligent to uncover and report fraud. Real estate closings, once deemed a “meat and potatoes” area of practice, has suddenly become a minefield for fraud and enormous potential losses for lenders. As a consequence real estate lawyers, and all settlements agents weather or not they are members of the bar, must expect heightened scrutiny and new criteria for evaluating their ability to perform the important function of acting as a gatekeeper on behalf of lenders in their ongoing battle against mortgage fraud.

The Public Wants Change

In the past three years Secure Settlements commissioned three separate opinion polls seeking public input on issues surrounding mortgage closings. The results were consistent and nothing less than fascinating, as well as a wake-up call for the industry.

An overwhelming majority of respondents believe that only attorneys should be permitted to act as settlement agents, that the attorneys should be more carefully regulated, that providing for their independent certification based on criteria including experience, is essential to establishing public faith in the process. Furthermore, 79% indicated that they were unaware settlement agents are not all obligated to have E&O coverage when handling their real estate matters, 92% believe that settlement agents should meet minimum uniform standards or experience and skill besides being licensed, 93% believe that banks need programs to better identify people who may commit fraud in mortgage closing transactions, 97% believe banks need policies and procedures to ensure that whoever handles the closing funds and documents is trustworthy, 44% believe banks giving mortgage loans are doing enough to protect consumers from losses from fraud, while 56% say they are NOT doing enough. Interestingly, in contrast to public positions taken by some agent groups, 93% of the public polled in the survey stated that they would feel more comfortable at a closing with someone who had an independent, vetted designation. Finally, 70% of those polled believe that with improvements such as additional protections from fraud at closing, lenders can rebuild the public’s trust in the financial industry without government intervention. (*American Money Services, Oct 2012*).

After decades of allowing the title industry to regulate risks at closing it’s time for industry leaders and regulators to require a more independent and reliable source of protection from closing fraud.

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One Billion for origination Fraud, Not One Cent for Closing Fraud?

The mortgage industry spends upwards of \$1 Billion annually to fight mortgage fraud on the front end of the process (origination, processing and underwriting)(MBA Figures 2011). There is no uniform approach to addressing risk at the back end of the process (closing) other than reliance on the Closing Insurance Letter/Closing Protection Letter (in those states where it is permitted). The CIL/CPL is not risk management, is not insurance, does not adequately cover the consumer and lender from all losses, and is reactive not proactive.

In the absence of greater risk management, lenders remain at risk from fake title agencies and settlement companies, theft of mortgage proceeds, improper disbursements of mortgage proceeds, failure to follow closing instructions and properly document closing details, failure to disclose cash outside of closing, failure to disclose true source of funds brought to closing, conspiracies to commit fraud: short sale fraud, foreclosure rescue scams, undisclosed intervening transaction flips, straw buyers and identity thefts, negligent document handling, failure to properly record instruments and failure to return closing packages. The result? repurchases, audit issues, litigation and billions in losses.

In the absence of greater risk management, consumers remain at risk from fake title agencies and settlement companies, theft of mortgage proceeds, theft of consumer contributions to closing, improper disbursements of mortgage proceeds, failure to pay off prior liens and judgments after closing, failure to follow closing instructions and properly document closing details, negligent document handling, failure to properly record instruments and failure to return closing packages. The result? Clouds on title, litigation costs, and untold losses.

Vetting and Risk Management Must Be Independent

Secure Settlements supports independent risk management to avoid the inherent conflicts of interest where sales and operations meet, as was prevalent in the mortgage lending industry before the most recent collapse in 2008. Banks, title underwriters and even associations have financial interests which could create conflicts if they were to be the focus of a national program for uniform risk management.

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In addition to independence, SSI supports comprehensive risk management. This approach requires (a) uniform evaluation standards, (b) individual vetting (as opposed to entity level vetting that takes place today), (c) ongoing monitoring for up to date risk assessments, and (d) a shared database of good and bad actors accessible by warehouse banks, mortgage lenders, realtors and consumers to ensure better third party service provider and business referral decisions.

Since launching SSI in June 2012 we have successfully built a database of vetted agents, as well as a watch list component of verified high risk individuals, that now exceeds 45,000 names. The list is being accessed by several warehouse banks and dozens of lenders nationwide who see the value in a shared database of information as a risk management tool. They know when they access the list each agent has been independently evaluated in accordance with a set list of comprehensive risk factors. This process has been shared by me with regulators at CFPB, OCC, FDIC, NCUA and policymakers in Washington DC who recognize the value in applying a new benchmark for evaluating and monitoring risk to the closing process, both to better protect banks but also protect consumers from harm.

The objections we have heard from some in the industry can be summarized as follows:

- “We don’t need more risk management”
- “We are already vetted”
- “We have our own best practices and that’s enough”
- “We are licensed”
- “We belong to an association”
- “Our personal data is private”
- “We don’t cause fraud, mortgage brokers do”
- “Vetting costs too much (\$199/\$99 for a year)”

Meanwhile, every day lenders wire Millions of Dollars into the trust accounts of escrow and closing agents with whom they have little or no relationship, and every day thousands of consumers arrive at mortgage closing ceremonies conducted by individuals who have no uniform standards of care, no uniform best practices, uniform licensing, nor comprehensive identity and credential verification.

Finally, it is clear that the industry needs real insurance coverage in place of the CPL. It must be uniform in coverage, insure all parties who can be harmed (warehouse banks, lenders, buyers and sellers, and investors), be available in all 50 states and US territories, and be affordable.

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Most importantly, no such policy can possibly exist without an underwriting platform that involves independent risk management for the agents whose acts and omissions the policy would cover. Best practices are not enough, vetting, monitoring, risk rating all supported by greater targeted education programs (fraud deterrence and detection, closing table ethics and so on) are necessary.

I have been working with insurers domestically and overseas for four years helping to design such a product. We believe that independent vetting such as that being offered by SSI (and others) backed by a new form of closing protection insurance will relieve the title industry of a function that is not consistent with their primary mission of title insurance, and will provide real protections to everyone in the mortgage closing process. It won't change the closing process, but it will transform the results.

Thank you for the opportunity to be heard on this issue.

Respectfully,

Andrew Liput

Andrew Liput
President & CEO
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