



Closing Protection Letters: Overlooked Indemnity Coverage For Common Foreclosure Defense Claims

Joanne N. Davies, Esq. and Randall L. Manvitz, Esq.

Mortgage lenders are all too familiar with borrowers' assertions that they did not receive two properly dated copies of the Truth-In-Lending Act ("TILA") mandated Notice of Right to Cancel form ("NORTC") at closing. Under TILA, the failure to provide two copies of the NORTC form allows a borrower to rescind the loan years after the closing. As a result, this claim has become a standard borrower assertion in defense of a foreclosure action.

While frequently overlooked by mortgage lenders and their counsel, these types of claims are often covered by a little understood title insurance indemnity agreement commonly known as a closing protection letter or insured closing letter. The closing protection letter provides the lender with the ability to recover its losses from the issuer of the closing protection letter which is generally a title insurance underwriter such as Fidelity National Title and its many brand of companies (Chicago Title, Commonwealth Land, Alamo Title, Tigor Title), First American Title Insurance, Stewart Title, and Old Republic National Title. This article provides an overview of closing protection letters and their coverage of NORTC claims.

1. Closing Protection Letters

Title underwriters issue closing protection letters to lenders to provide an assurance to the lender that the underwriter's issuing agent, a title/escrow company or closing attorney, appropriately handles the signing of the loan documents and disbursement of the loan proceeds. The American Land Title Association ("ALTA") has promulgated various forms of the closing protection letter since 1987. Many forms are broad in scope and cover all future transactions involving the lender and issuing agent, but some apply to a single transaction. A small number of states have promulgated a specific form and at least one state, New York, does not allow them. Likewise, in order to limit their risk exposure, some title insurance underwriters have made modifications to the standard ALTA forms such as adding clauses to include deadlines for claims, precluding claims based on consumer protection laws, or establishing monetary limits to the indemnity amount. A close review of the form of the particular closing protection letter at issue is necessary to determine coverage.

2. Problems With Locating The Closing Protection Letters

It is not uncommon for a lender to be unable to locate the closing protection letter despite having a policy and practice of requiring them. One source for finding the missing closing protection letter is from the title/escrow company or closing attorney that was responsible for closing the transaction at issue. They often have electronic access to the title underwriter's database of historically issued closing protection letters or may have kept a copy of closing protection letters in their own files. However, with the financial crisis of 2008, many of the title/escrow companies and closing attorneys are no longer in business. The major title underwriters have generally survived the financial crisis although they may have consolidated various brands. It is not in the interest of the title underwriter to locate an applicable closing protection letter so expect that the first response is that no such letter exists. Significant discovery is often necessary to obtain the letters or access to the database to show an applicable letter was issued.

3. Truth-In-Lending Claims For Notice of Right To Cancel Forms

In the mid-2000s, Plaintiffs' attorneys began sending letters to thousands of borrowers at a time informing them that they may be entitled to significant damages or to rescind their loan if the borrower was unable to locate two properly completed copies of the NORTC. Cookie-cutter claims poured in claiming that borrowers were not provided appropriate NORTC forms. Now, the assertion is commonly made in defense to foreclosure actions. The amounts at issue can be significant. A borrower will claim to be entitled to the return of all of the closing costs and interest paid over the life of the loan plus attorneys' fees. Rescission of the loan involves termination of the lender's security interest.

The good news for lenders is that these claims may be covered by a closing protection letter.

4. Language Of The Closing Protection Letter That Provides Indemnity

The typical closing protection letter requires the title insurer to pay the lender for "actual loss" "arising out of" the closing and involving either:



Paragraph 1: Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursements of funds necessary to establish such status of title or lien, or (b) the obtaining of any other document, specifically required by you, but only to the extent that said instructions requires a determination of the validity, enforceability or effectiveness of such other documents, or (c) the collection and payment of funds due you, or

Paragraph 2: Fraud or dishonesty [or negligence] of the Issuing Agent or Approved Attorney in handling your funds or documents in connection with such closings.

ensues over what is recoverable under “actual loss.” A few examples of the areas often debated are whether “actual loss” includes attorneys’ fees and loan write-offs.

Whenever a borrower asserts a TILA claim based on a NORTC form, lenders and their counsel should diligently analyze whether they have a claim for indemnity based on a closing protection letter. Coverage under a closing protection letter may result in a significant recovery.



Joanne N. Davies is a Shareholder in the Firm's Orange County office. She can be reached at 949-224-6221 or jdavies@buchalter.com



Randall L. Manvitz is Senior Counsel in the Firm's San Francisco office. He can be reached at 415-227-3644 or rmanvitz@buchalter.com

Coverage Under Paragraph 1:

Many lenders’ standard form closing instructions require that the settlement agent provide two properly completed NORTC forms to each borrower. Paragraph 1 covers loss related to a borrower’s TILA claim that the settlement agent failed to provide the appropriate NORTC forms as required by the closing instructions. The condition that the closing instructions relate to the “priority of the lien” is met because the remedy for a TILA claim based on a NORTC form is rescission of the loan which voids the lien. Title underwriters have agreed that actual losses caused by the failure to follow closing instructions resulting in a borrower’s claim that the lien is invalid is covered by Paragraph 1 of the closing protection letter.

Coverage Under Paragraph 2:

The indemnity provided by paragraph 2 covers an overlapping but separate set of circumstances. Title insurers have agreed that if the issuing agent failed to appropriately distribute the NORTC forms as it was supposed to, the lender’s actual loss would also be covered by Paragraph 2. Notably, the language of paragraph 2 does not have the same limiting language to matters that affect the status of title or enforceability of the mortgage as found in paragraph 1. However, some closing protection letters may include limiting language.

5. What Is The Scope Of The “Actual Loss” Covered Under The Closing Protection Letter

Actual loss is not defined in the closing protection letter and there is scant case law discussing “actual loss” as used in the closing protection letter. As a result, significant debate often