Misplaced Trust

What kinds of errors does the title insurance agent make? My answers aren't scientific; they are based on 30 years of experience in fixing problems for title insurers. I've seen clerical errors — e.g., failing to take exception for an encumbrance shown on a title commitment, or issuing a policy when some of the commitment's conditions are unsatisfied. Preventing these kinds of errors requires training, supervision and unremitting attention to detail. Beyond that, I have little to say regarding them.

Other preventable errors involve misplaced trust. As Ronald Reagan said, "trust but verify." This advice isn't always easy to follow when dealing with a customer or colleague. A title agent's natural desire to please a customer can discourage the agent from detecting and stopping preventable frauds. For example, you may feel uncomfortable telling a customer who brought a certificate of satisfaction to a closing that you'll need to verify the certificate with the lender. This precaution, although necessary, could be interpreted as an accusation, creating an uncomfortable situation. To ask a probing question of a co-worker may be even more uncomfortable since you'll be seeing him or her at the office tomorrow.

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Agents who are too trusting risk being defrauded. Three cases from the files of Bean, Kinney & Korman will illustrate. Two of the cases involve misplaced trust in the parties to a closing. The third doesn't involve a specific closing, but concerns misplaced trust in a long term colleague. Names and details have been changed so as not to embarrass anyone. The cases illustrate that the consequences of misplaced trust can be serious or catastrophic. At the end of the article, I'll make some suggestions for reducing the risk of misplaced trust.

"Here's the release you wanted."

Mr. and Mrs. Newlywed were delighted with the purchase of their new home until they received a foreclosure notice from a lender they'd never heard of. Fortunately, they had purchased a title insurance policy. They filed a claim, and the insurer hired my firm to investigate. A title search showed the foreclosure notice had come from the seller's lender, so I called the seller to ask what was up. When he hung up on me, I knew we had a problem on our hands.

The settlement agent told me that closing preparations seemed to be going well until shortly before the closing, when the agent realized that the seller had not provided contact information for his mortgage lender. The settlement agent wasn't dealing with the seller directly, but rather with a real estate broker who held the seller's power of attorney. When the settlement agent asked about the seller's mortgage, the seller's agent said there would be no problem because the loan had been paid off. On the closing date, the seller's agent produced a certificate of satisfaction that had been recorded two days previously. The settlement agent accepted the certificate as proof that the mortgage had been satisfied, and proceeded with the closing.

Then came a shocking development. The seller's lender claimed the certificate of satisfaction was a forgery, and there was still $500,000 owed on the seller's mortgage. Who could have guessed?

Well, dear reader, I'm hoping you could. Here were some warning signs:

- The seller was represented by an attorney-in-fact. Your underwriter has warned you about powers of attorney, hasn't it? They aren't illegal, but they are often used in committing fraud.
- The certificate of satisfaction was recorded two days before the closing. This should have raised questions because most sellers wait until closing to pay off their mortgages. Few homeowners have the cash available to pay off a mortgage without selling the property or refinancing it.
- A quick reading of the certificate of satisfaction would have exposed it as a clumsy forgery. The certificate said it was notarized in Los Angeles, but the notary's seal bore a lone star, surrounded by the words, "State of Texas."

The Newlyweds' title insurer saved them

from foreclosure by paying off the seller's mortgage. The insurer then had us sue the seller and his agent and, to our surprise, they paid back the $500,000. Later we learned they raised the money by stealing it from someone else. The FBI has been notified.

"Don't contact the lender."

To all appearances, Mr. Bigshot was a successful businessman who shared his wealth generously with friends and employees. However, the title report for a sale of one of his investment properties told a different story. The property was subject to "piggyback" first and second mortgages to a subprime lender, plus a third mortgage to an individual. Beyond the mortgages, there were a number of judgments to be paid off. The closing was to be a short sale and a "RUSH." The settlement agent faced a daunting task of getting all the required payoff statements in time for the closing.

Mr. Bigshot arranged for his attorney (so it seemed) to supply the payoff statements from his first and second mortgage lenders. The statements came to the agent under cover of a fax transmission from the attorney's office. The fax cover sheet was on the attorney's letterhead. The payoff statements appeared to come from the lender. The statements said the payoffs should be made by check to a post office box in Baltimore used by the lender's "Special Asset" department and instructed the settlement agent *not* to contact the lender at its usual office. Aside from the post office box, the payoff statements provided no contact information for the lender's Special Asset department.

With hard work, the settlement agent got all of the other required payoffs, and closed the short sale on schedule. Unfortunately, the payoff statements received from Mr. Bigshot's attorney were fakes. Mr. Bigshot, who actually was one of the attorney's clients, asked the attorney's receptionist if she wouldn't mind faxing the payoff statements to the title insurance agent, and she was glad to oblige. The post office box wasn't actually rented by the lender, but by a limited liability company Mr. Bigshot formed under a name similar to the lender's. The company was able to cash the payoff checks, and Mr. Bigshot got the payoff money. He later got 20 years in jail, and the title insurer got a major claim.

I didn't follow what happened to the agent, but it probably wasn't good. The agent had failed to pay attention to several warning signs:

- The seller was in financial difficulty.
- The payoff statements did not come directly from the lender.
- The payoff statements instructed the agent not to communicate with the lender's main office and provided no contact information (except a post office box) for the lender's "Special Asset" department.
- Most lenders in these circumstances would require wired funds or (less likely) an official bank check.

Trusted Employee

The owner of a title agency appeared to be blessed with a talented employee who worked hard and contributed to every aspect of the agency's business. Trusted Employee could underwrite commitments, relate well to customers at a closing, and handle administrative work, like bookkeeping and disbursing. Trusteed Employee's computer skills were exceptional.

Owner had sole authority to write checks on the agency's escrow account, but he got tired of signing checks and decided to purchase a signature machine to automate the process. The machine allowed Trusted Employee to sign Owner's name to escrow account checks. You can probably guess what happened next. Trusted Employee signed Owner's name on escrow account checks payable to Trusted Employee's friends and relatives.

Trusted Employee was able to keep doing this for several years because the agency had a growing business, and there always seemed to be plenty of money in the escrow account. To conceal the thefts, Trusted Employee altered the company's computer records to disguise the unauthorized checks as payments of settlement costs or, in a few cases, payoffs of mortgage loans. At a different agency, the company bookkeeper might have alerted management to this kind of problem, but Trusted Employee kept the books for Owner's agency. Owner would have discovered the thefts if he had reconciled the company's computer records with its bank statements or returned checks, but Owner did not do these things. The escrow shortages continued to increase.

When the agency's business slowed down, the escrow account got leaner, and Owner discovered the thefts. The agency's underwriter had to pay the unpaid mortgages and deal with other claims caused by the escrow shortage. The underwriter hired my firm to deal with the claims and to sue the agency. The agency's malpractice insurer ultimately reimbursed the underwriter for many of the losses, but the agency went out of business.

Preventing Misplaced Trust

Here are some ideas for reducing the risk of losses due to misplaced trust.

- Be aware that frauds occur, and the people who commit them can be likeable and appear trustworthy.
- There may be obvious tip offs to a fraud, but you need to be alert for them.
- Keep your guard up in rush or high pressure situations.

These kinds of situations are conducive to fraud.

- Have a plan for dealing with the human relations aspect of a potential fraud. Be confident in your right to ask for information or clarification, and think about ways to do this that won't be confrontational or embarrassing. If you need to ask probing questions, you can do it politely by stating that your underwriter requires the information or needs verification.
- If something doesn't seem right about a transaction, call a time out. You might want to step into a different room to give the matter more thought, consult a colleague, or call the underwriter's agency counsel for advice.
- If you own a title insurance agency,
    1. destroy any signature machine immediately;
    2. assign payment and bookkeeping responsibilities to different employees;
    3. have an accountant set up or review your procedures for handling funds.

About the Author

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What would you do?

"Underwriting and claims solutions from ARTU, Esq." ARTU (Anal Retentive Title Underwriter who is spending his time "down on the farm"), Esq. is the ideal title insurance counsel — a problem solver who understands not only the legal issues, but the reality of each particular risk determination and claim.

QUESTION

You are underwriter claims counsel and are presented with the following facts: Your insured, Donnie Developer, purchased a 10 acre parcel for $450,000 (and an owner's policy) which he intended to develop. Some months later, it was discovered that the property was encumbered by a 99 year farm lease dated in 1989 and which covered the entire 10 acres. The lease required a $3,000 per year payment to the fee owner. However, you have discovered that the property has never been farmed, and no payments have ever been made. You have located a Mr. Gentry, the lessee and asked for a release, and have been told that he will grant a release in exchange for a payment of $850,000. Your research indicates that having the lease declared void due to nonuse and or nonpayment is not encouraging. An appraisal reveals the property is worth $500,000 without the encumbrance, and $35,000 with the encumbrance. What are your options?

ANSWER

The options are few and not good. Although Mr. Gentry apparently has no interest in the lease, he does recognize that he has everyone over the proverbial barrel. The options are:

1. Litigate and hope for favorable decision which would require only the payment of attorney fees.
2. Litigate and lose, and pay fees and the loss of $465,000.
3. Pay $465,000 and terminate all obligations under the policy
4. Attempt to negotiate with Mr. Gentry, who has nothing to gain by winning the suit, but who may be able to prevent development of the property.