AMERICAN
LAND TITLE
ASSOCIATION

August 1, 2011

The Honorable Mary L. Schapiro
Chairman
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
File Number S7-14-11

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RIN 2501-AD53

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Docket No. R-1411

Robert E. Feldman
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RIN 3064-AD74

Dear Sirs and Madams:

Thank you for this opportunity to comment on the above referenced joint rulemaking implementing Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”)[1]. As regulators seek to improve upon and finalize the proposed rule, the American Land Title Association (“ALTA”)[2] urges regulators to include in their definition underwriting standards for proving legal title to the property. A title search backed by a title insurance policy is a market-oriented, commonsense mortgage underwriting feature that helps lower the risk of default and loss for the borrowers, lenders and investors and thus should be included in a final Qualified Residential Mortgage framework.

[1] Public Law 111-203, (July 21, 2010).
[2] The American Land Title Association, founded in 1907, is a national trade association and voice of the real estate settlement services, abstract and title insurance industry representing more than 3,800 member companies. With more than 8,000 offices throughout the country, ALTA members operate in every county in the United States to search, review and insure land titles to protect home buyers and mortgage lenders who invest in real estate. ALTA members include title insurance companies, title agents, independent abstracters, title searchers and attorneys, ranging from small, one-county operations, to large national title insurers.

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Last year, Congress passed new financial reform legislation to prevent risky mortgage lending from causing a repeat of the housing bubble and resulting recession. One of the methods adopted by Congress to discourage risky mortgage lending was included in Section 941 of the Act, which requires securities issuers to retain 5 percent of the credit risk in any residential mortgage backed security. However, to further incentivize safe mortgage lending, Congress authorized an exemption from this requirement for securities backed entirely by "Qualified Residential Mortgages." While Congress left the technical requirements to the joint regulators, its mandate to regulators was clear, directing them to "promote a sensible mortgage standard that would encourage sound underwriting and responsible lending[3]" by considering "underwriting and product features that historical loan performance data indicate result in a lower risk of default[4]."

Despite this mandate to promote safe mortgage underwriting, the proposed rule misses the mark because it fails to include sensible requirements for underwriting legal title to the collateral. This underwriting, through a title search backed by a title insurance policy, is an essential aspect of safe mortgage lending that is endorsed by the Federal Housing Finance Agency (as conservator for Fannie Mae and Freddie Mac), the Department of Housing and Urban Development and the private market. However, the creation of a QRM standard that is silent on such an important underwriting step would serve to undermine the market as lenders seek market advantage by cutting corners. Without the inclusion of appropriate title standards the rule will make mortgage lending more risky.

**Title insurance is a best practice that is necessary for meeting the eligibility criteria of the QRM**

The proposed rule limits the QRM exemption to "closed-end first-lien mortgages to purchase or refinance a one-to-four family property." However, the rule does not establish standards for how this requirement will be met and verified. ALTA urges the regulators to adopt clear standards for compliance with this criterion including the creation of a safe harbor for loans backed by a title insurance policy.

Most secondary market participants, including Fannie Mae, Freddie Mac and private investors require mortgage originators[5] to represent and warrant that each mortgage loan that

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[3] Senators Kay Hagan, Johnny Isakson, and Mary Landrieu, "Home-Buying Rule Would Hit Recovery." *Politico*, May 12, 2011. Available online at [http://dyn.politico.com/printstory.cfm?uuid=48E94B58-A65B-4EBE-9903-599286D92B8F](http://dyn.politico.com/printstory.cfm?uuid=48E94B58-A65B-4EBE-9903-599286D92B8F). Last visited May 24, 2011. Senators Hagan, Isakson and Landrieu were the chief authors and sponsors of the QRM provision.

[4] Public Law 111-203, Section 941(c).

[5] See Fannie Mae's "Selling Guide" Chapter B7-2, Title Insurance and Freddie Mac's "Single-Family Seller/Servicer Guide" Chapter 39: Title Insurance. Fannie Mae requires, "Before purchase or securitization, each first mortgage loan delivered to Fannie Mae must have a title insurance policy in place that satisfies Fannie Mae's requirements." Freddie Mac requires, "Each Mortgage purchased by Freddie Mac must be covered by… A paid-up Mortgage title insurance policy meeting the requirements in Section 39.2"

they purchase is a first-lien mortgage. If this representation and warranty are breached, then the originator is required to repurchase the mortgage loan. While this representation and warranty is typically satisfied through a title search and examination backed by a title insurance policy, some mortgage lenders may seek to skirt this best practice to obtain a market advantage. Rather than take a wild west approach, ALTA urges regulators to adopt the purchase of a loan title insurance policy as a best practice that “help[s] ensure that such residential mortgages are of very high credit quality.”

**A title insurance safe harbor would better protect consumers, lenders and investors than a reason to know standard**

Question 114(a) requests comment on the legal standard lenders should be held to for compliance with the first criteria. The question suggests that the lenders should be held to a “reason to know” standard and that the lender must not have reason to know that there exists other “recorded or perfected liens on the one-to-four family property.” A party has a reason to know when “a person of reasonable intelligence . . . would infer that the fact in question exists, or that such person would govern his conduct upon the assumption that such fact exists[6].” A “reason to know” standard does not impose a duty of inquiry but merely requires that a party draw reasonable inferences from facts already known to them[7]. By instituting a “reason to know” standard, the rule will encourage lenders to avoid liability by conducting minimal due diligence to avoid having a reason to know. If the goal of this legal standard is to encourage lenders to make safe mortgage loans and to conduct appropriate due diligence, a “reason to know” standard misses the mark.

Rather than creating a “reason to know” standard, regulators should consider creating a legal safe harbor that encourages creditors to use best practices, including a title search and examination backed by a title insurance policy. Just as the Federal Reserve Board has recognized in its ability to repay proposed rule[8], a safe-harbor will encourage lenders to conduct the necessary due diligence. Further, the more conclusive the requirements of the safe harbor are, the more likely lenders will be to comply with its requirements.

Allowing a loan title insurance policy as a method of meeting this safe harbor would prove a cost-effective method of meeting the first-lien position criteria without any disruption to the mortgage origination market. Further, for reasons discussed below, the due diligence

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[6] RESTATEMENT (SECOND) OF AGENCY § 9 cmt. d (1958); see also RESTATEMENT (SECOND) OF TORTS § 12(1) (1965).

[7] See Novicki v. Cook, 743 F.Supp. 11, 13 (D.D.C.1990)) defined "reason to know" under Section 9.406-5(b) according to the Restatement definition

[8] “The drawback of treating a ‘qualified mortgage’ as providing a presumption of compliance is that it provides little legal certainty for the creditor, and thus little incentive to make a "qualified mortgage," which limits loan fees and features .” See Federal Reserve Board’s Proposed Ability to Repay Rule FR Doc No: 2011-9766 Page 256. Available at http://www.gpo.gov/fdsys/pkg/FR-2011-05-11/html/2011-9766.htm.

already performed by the title industry to safely underwrite the insurance policy will ensure that the goals of the criteria are met. For these reasons, we urge regulators to clarify how lenders can comply with the first-lien eligibility criteria by obtaining a loan title insurance policy.

**The title insurance process identifies debt obligations not found anywhere else that can affect a borrower's debt-to income ratio and ability to repay the mortgage loan.**

To qualify for a QRM loan under the rule, borrowers will have to meet strict debt-to-income requirements that ensure the borrower has the ability to repay the mortgage loan. Thus, the rule requires lenders to examine the borrower's credit history, income information and outstanding debt to make these determinations. However, the data tools and documentation will not provide lenders a complete view of the outstanding debt involved in the mortgage transaction. ALTA believes that obtaining a title insurance commitment will provide lenders a more complete picture of the borrower's debt by showing debts tied to the collateral's title that cannot be found in a credit report.

One of the main excesses of the bubble that Dodd-Frank attempts to remedy is to reduce the number of loans made by lenders that the borrower would never be able to repay based on the lender's belief that if the borrower defaulted, the collateral's value would be sufficient to fully satisfy the debt. However, as housing prices fell, this belief proved incorrect and cost borrowers their home and cost creditors significant losses.

Both the ability-to-repay and qualified residential mortgage requirements attempt to remedy this problem by forcing lenders to underwrite the borrower's financial condition at the time of the loan. The lender is required to make a determination "the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments[9]." To make this determination, the creditor must consider "the consumer's credit history, current income, expected income the consumer is reasonably assured of receiving, current obligations, debt-to-income ratio or the residual income the consumer will have after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than the consumer's equity in the dwelling or real property that secures repayment of the loan[10]."

While this provision recognizes the value of examining the borrower's financial history, the history of the legal title to the collateral must also be examined.

The title insurance process provides information to the mortgage originator that a credit report does not, and identifies additional debt obligations that could affect the borrower's debt-to-income ratio. Not all debts are evidenced in a credit report. Rather, many debts are secured by liens against the property that only show up after a title search and examination are performed. Unless satisfied at closing, these secured debts become the obligation of the borrower when they take title to the collateral. Prudent underwriting of a borrower's ability to

[9] 15 USC § 1639c(a)(1).
[10] 15 USC § 1639c(a)(3).

repay would require that a creditor evaluate the title to the collateral to determine what outstanding debts must be satisfied before the creditor can obtain a first-lien mortgage. We ask regulators to clarify this important step.

**Title insurance is an essential underwriting feature that reduces risk in the mortgage transaction.**

Promoting sound underwriting and responsible lending does not just require regulators to fix credit underwriting weaknesses exposed during the bubble, it also necessitates that regulators enfranchise underwriting strengths that proved their value. Therefore we draw your attention to one of the underwriting features that continues to prove its value: underwriting the legal title to the real property that serves as collateral for the mortgage loan.

At its most basic, mortgage origination involves two essential underwriting steps, underwriting the borrower and underwriting the collateral. While credit underwriting standards went lax during the bubble, standards for analyzing legal title remained strong.

**Title insurance directly reduces the risk of default.**

At its heart, title insurance is a credit enhancement product that makes a mortgage loan safer for borrowers and more attractive to investors. By indemnifying the lender and subsequent investor (in the case of a loan policy) and borrower (in the case of an owner's policy) against financial harm due to a failure of title as insured, the policy reduces the risk of a title failure. By reducing the instances in which a third party can defeat the borrower's title and the lender's lien priority and compensate them if that risk cannot be mitigated, title insurance directly reduces the risk of default.

In general, the land title industry offers two types of title insurance policies, both of which are typically issued at or after the closing of a real estate or mortgage financing transaction: an Owner's Policy and a Loan Policy. An Owner's Policy insures the borrower against financial loss or damage arising from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records, but were not discovered during a search of those records or their significance was not appreciated. The policy also includes protection against non-recorded defects that even the most comprehensive search of public records would not reveal. Without a title insurance policy, a borrower would self-insure the risk of losing their title. Besides losing their home, borrowers would be financially responsible for: the loss of the purchase funds and any improvements; the costs of defending their rights including legal fees and court costs; and the costs of obtaining new housing.

A Loan Policy insures the holder of the promissory note that it will have a valid, enforceable lien on the property in accordance with the mortgage rights created by the loan; that the person to whom the loan is being made has title to the property used as collateral; and that no other claimant, other than those specifically noted in the policy has a prior, superior claim.

The title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. Without the policy, the holder of the note would self-insure the risk of losing access to the property if the borrower defaults. Further, the loan policy follows the note and transfers to each subsequent holder of the note throughout the securitization process.

Unlike other lines of insurance, title insurance actively seeks to mitigate risk before a transaction closes by conducting a title search and examination. Risk identification and elimination is of unquestioned benefit to the purchaser, seller, lender, title agent, title underwriter and the public. The process identifies any possible problem with the title that affects the use of the property or its value before property is purchased. It almost goes without saying that if the borrower loses title to their property their incentive to continue making their mortgage payments decreases dramatically.

**By mitigating risk against potential loss before closing, title insurance prevents defaults related to the property's legal title.**

To understand how title insurance helps prevent default it is important to understand the title insurance process.

The "ownership" of real estate involves the interest in a bundle of rights relating to the use of, and disposition of real property. This concept is called title, and these rights can be transferred individually or collectively. Prior owners may have created interests in a property or suffered liens against a property that will affect the interests acquired by a new purchaser. Potential buyers need to know which rights have been removed from, or added to, the bundle as this will affect the use of the land, and as a result, its value.

In the United States, real property is conveyed by a private contract that is most commonly called a deed. These private agreements are memorialized in local public records, putting the world on notice of the transfer. Since governmental agencies do not routinely verify land titles, buyers, sellers and mortgage creditors depend on the land title industry to research public records in order to determine various facts related to title, including how title is legally vested. It is this meticulous work performed by land title professionals that fosters the trust necessary in public records so that equity in real property can be exchanged for mortgage credit.

Once a sales contract is signed and financing is secured, title professionals collect the relevant records and information pertaining to the property to be insured, and information regarding possible claims against the seller (or owner in a refinance transaction) that could affect the title to the insured property. This is referred to as the "title search" and the information collected is the "title evidence."

Having collected the title evidence, professionals experienced in real estate law and title insurance examine the title evidence to determine: (i) whether the seller has, and can convey, fee simple title to the buyer; (ii) what other liens or other objections must be resolved or corrected; and (iii) what title defect exceptions may have to be included in the policy. It is at this “title examination” stage that the title agent performs one of the most valuable services for safely underwriting a mortgage: curing defects and problems that may exist in the title records. This curative action includes obtaining releases or pay-offs for discovered liens (e.g., prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner’s association debts, mechanic liens); and correcting typographical recording and indexing errors that could create problems (e.g. misspelled names, incorrect legal descriptions). In 100% of all real estate transactions curative work must be conducted to ensure the transfer of clear title to the buyer and the lien priority of the new mortgage.

This vital process produces confidence in the mortgage transaction. Lenders typically require title insurance as a condition of providing financing for the transaction to assure itself that the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable first-lien mortgage that is not subject to any other lien or claim that could adversely affect its interest. This practice is a testament to the inherent value of title insurance for reducing risk in the transaction.

**Title insurance protects against the two key drivers of mortgage default, negative equity and illiquidity.**

Over the last few years, two major theories have developed to explain mortgage defaults. The first is unforeseen changes in a borrower’s financial status that leave them unable to make their mortgage payments (a liquidity shock) [11]. Such events include divorce, death of a family member, medical expenses, job loss, etc. The second theory is strategic default, where borrowers choose to abandon their mortgage obligations despite being able to pay, usually due to loss of equity[12].

Regulators looking to reduce the risk of default should promote underwriting features, like title insurance that help prevent these two main triggers. Despite extensive loss mitigation efforts by the industry, not all defects can be cured before closing. Thus, a title insurance policy also covers against title risks that, while they occurred before closing, were undiscoverable or not known until after closing. By curing these defects or paying a claim to make the consumer whole, the title insurance policy protects borrowers from challenges to their title, which, without the policy, would result in a financial shock to the borrower.

One ALTA member’s data for 2010 shows that on average between three and six transactions per 1,000 in which an owner’s policy was purchased have received a claim against the policy. These claims insure against lost home values due to things ranging from

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[11] Elul, Ronel et al. “What “Triggers” Mortgage Default?” Federal Reserve Bank of Philadelphia Working Paper No. 10-13. April, 2010. Available at http://finance.wharton.upenn.edu/~souleles/research/papers/PhilaFedwp10-13.pdf.

[12] Bhutta, Neil, Jane Dokko, and Hui Shan," The Depth of Negative Equity and Mortgage Default Decisions," 2010-35 June, 2010. Federal Reserve Finance and Economics Discussion Series. Available at http://www.federalreserve.gov/pubs/feds/2010/201035/201035pap.pdf.

undiscovered liens or rights of ownership to instances of fraud and forgery in the current transaction.

In total in 2010, title insurers paid $919 million in claims. Without a title insurance policy, these losses would have come directly from borrowers and lenders either as a direct expense or lost home value. Already, about 23% of all U.S. homes are "under water," that is, they are worth less than the amount of the outstanding mortgage.[13] Adding another $919 million onto the lost home values borrowers would likely have placed even more Americans "under water" and possibly into default.

Besides coverage for claims, title insurance also covers the cost of defense for borrowers and lenders. This valuable service more acutely impacts a borrower's financial stability. This protection is available whenever a third party challenges the title as insured, even if the challenge is frivolous and does not result in a claim.

Industry data shows that on average, title insurers spend $20,000 per lawsuit to defend a borrower's title. Without a title insurance policy, this amount would come directly out of the borrower's pocket and would likely lead to the borrower defaulting on the mortgage.

According the Federal Reserve's "2009 Panel Survey of Consumer Finances," the bottom 40 percent of Americans has roughly $8,800 in median financial assets with the 40$^{th}$-60$^{th}$ percentile having roughly $21,600[14]. Thus, 40 percent of borrowers would be in no fiscal position to defend their title if a challenge is made. This number will likely be higher once the regulator's proposed 20 percent down payment is deducted from American's bank accounts.

According to U.S. Census Bureau data, the bottom 40 percent of American households represents roughly 25 million homeowners with an annual income of $40,000, almost all of which have a mortgage[15]. If 0.3-0.6 percent of these 25 million homeowners had to defend their own title challenge, between 75,000 and 150,000 homeowners would be at risk for a default each year.

**By acting as independent third parties to the transaction, the title industry ensures that the underlying contractual obligations are executed as they are written.**

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[13] For example, see "Report: 23% of Mortgaged Homes 'Underwater'", PBS Newshour November 2009, http://www.pbs.org/newshour/updates/business/july-dec09/underwaterhome_11-24.html Source data are in "New Corelogic® Data Shows 23 Percent Of Borrowers Underwater With $750 Billion Dollars Of Negative Equity," Proposed Down Payment Rules Will Impact Already Hard-Hit States," Corelogic press release March 8, 2011

[14] See, Jesse Bricker, Brian Bucks, Arthur Kennickell, Traci Mach, and Kevin Moore, "Surveying the Aftermath of the Storm: Changes in Family Finances from 2007 to 2009," Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, D.C., Report 2011-17, Table 2b.

[15] Current Population Survey 2009, Table HINC-01 Part 1.

An important aspect of the title insurance industry that should not be overlooked is that, at the settlement or closing, title agents are the independent third party to the transaction whose only interest is to ensure the integrity of the transaction and the protection of the consumer. Title professionals handle the funds that come from the borrower and the lender and disburse them to the appropriate parties in the transaction. The industry's function is to close the transaction equitably, honestly and in accordance with the agreed-upon instructions, and to get the funds and legal documents into the appropriate hands. Without this function, real estate and mortgage transactions are more susceptible to fraud.

**ALTA believes that the QRM rules unfairly and inappropriately restricts credit for worthy borrowers.**

In addition to efforts aimed at protecting borrowers, lenders and investors from legal title risks, ALTA urges regulators to prevent the QRM from serving as a barrier to homeownership for qualified low- and moderate-income American households. The proposed 20 percent down payment requirement, debt-to-income ratio and other credit standards will drive up borrowing costs for all borrowers, but especially creditworthy lower- and middle-income borrowers who could benefit from the consumer protections encompassed by the rule.

Dodd-Frank's risk retention provisions were designed to reduce mortgage risk. It attempts to achieve this in two ways: first, by requiring that lenders have "skin in the game" to incentivize them toward making less risky loans; and second, by "promot[ing] a sensible mortgage standard that would encourage sound underwriting and responsible lending" through the qualified residential mortgage exemption.

The proposed rule seeks to artificially limit the size of the QRM pool to ensure that there is a robust non-QRM securitization market. However, if protecting consumers and limiting risky mortgages is the goal of the QRM it would be better to discourage investment in the riskier non-QRM market by broadening the number of consumers eligible for QRM loans and thus eligible for the exemption's protections.

According to an estimate by Mark Zandi of Moody's Analytics, non-QRM-eligible loans would be more costly than QRM loans, roughly 75-100 extra basis points than QRM-eligible loans[16]. Due to these increased costs, borrowers will likely lean toward a QRM loan, and its safer underwriting and features, when they are eligible. Likewise, it will be less costly for lenders to underwrite a QRM-eligible loan. Assuming that both risk retained loans and QRM-eligible loans equally reduce risky mortgage lending, it would be more cost effective and help more borrowers, lenders and investors to promote QRM-eligible loans over risk retention. ALTA urges regulators to rework the QRM eligibility to promote safer mortgages for the greatest number of creditworthy Americans.

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[16] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, "Reworking Risk Retention," June 20, 2011.

ALTA appreciates this opportunity to comment on the proposed QRM rule. The protection provided by title insurance is vital for underwriting a safe and sound real estate transaction. A title search, examination, curative work and the placement of both an Owner's and Loan Title Insurance Policy are best practices that protect borrowers, lenders and investors and should be included as you finalize the proposed rule. Should you have any questions, please do not hesitate to contact Justin Ailes, Vice President of Government Affairs at 202.261.2937.

Sincerely,

Anne Anastasi

Anne Anastasi
President