



Beware of the Cement Life Jacket:

The Problem with Mortgage Foreclosure Consultants and Home Equity Purchasers

by Ken Dzien, General Counsel, United Title Company

Today, we have rapidly increasing home values, highly leveraged financing to get into those homes, and a flat job market. This all results in an environment ripe for the mortgage foreclosure consultant. One can see advertisements and programs everywhere offering help to debt-ridden homeowners on the brink of, or in foreclosure. Of course, nothing is wrong with properly qualified individuals or professionals helping those in economic stress with refinancing or selling their homes. Unfortunately, there are those who seek to take unfair advantage of homeowners in economic trouble. The California Legislature has found that many so-called foreclosure rescuers are actually sleazy predators. Their efforts on behalf of the homeowners underwater in debt are tantamount to handing them a cement life jacket.

The legislative findings which precede Civil Code Section 2945 regulating foreclosure consultants sum up the situation very well. They state:

§2945. Legislative findings and declarations

(a). The Legislature finds and declares that homeowners whose residences are in foreclosure are subject to fraud, deception, harassment, and unfair dealing by foreclosure consultants from the time a Notice of Default is recorded pursuant to Section 2924 until the time surplus funds from any foreclosure sale are distributed to the homeowner or his or her successor. Foreclosure consultants represent that they can assist homeowners who have defaulted on obligations secured by their residences. These foreclosure consultants, however, often charge high fees, the payment of which is often secured by a deed of trust on the residence to be saved, and perform no service or essentially a worthless service. Homeowners, relying on the foreclosure consultant's promises of help, take no

other action, are diverted from lawful businesses which could render beneficial services, and often lose their homes, sometimes to the foreclosure consultants who purchase homes at a fraction of their value before the sale. Vulnerable homeowners are increasingly relying on the services of foreclosure consultants who advise the homeowner that the foreclosure consultant can obtain the remaining funds from the foreclosure sale if the homeowner executes an assignment of the surplus, a deed, or a power of attorney in favor of the foreclosure consultant. This results in the homeowner paying an exorbitant fee for a service when the homeowner could have obtained the remaining funds from the trustee's sale from the trustee directly for minimal cost if the homeowner had consulted legal counsel or had sufficient time to receive notices from the trustee pursuant to Section 2924j regarding how and where to make a claim for excess proceeds.

(b) The Legislature further finds and declares that foreclosure consultants have a significant impact on the economy of this state and on the welfare of its citizens.

(c) The intent and purpose of this article are the following:

(1) To require that foreclosure consultant service agreements be expressed in writing; to safeguard the public against deceit and financial hardship; to permit rescission of foreclosure consultation contracts; to prohibit representations that tend to mislead; and to encourage fair dealing in the rendition of foreclosure service.

(2) The provisions of this article shall be liberally construed to effectuate this intent and to achieve these purposes.

The foreclosure consultant problem is not unique to California. In June 2005, the National Consumer Law Center in Boston

published a report entitled, "Dreams Foreclosed: The Rampant Theft of Americans' Homes Through Equity-Stripping Foreclosure Rescue Scams". Homeowners fall for these scams because they are afraid of approaching the lenders themselves. Further, the homeowners want to keep their homes, and the consultants seem to offer that option. Actually, a homeowner would generally be farther ahead in the game by quickly selling the home the homeowner cannot afford, and pocketing the equity. Unfortunately, too often those dealing with foreclosure consultants end up losing their homes anyway and giving their equity to the consultant. The problem occurs because the foreclosure consultant is looking out for his own interests rather than those of the homeowner.

The rescue scams fall into three major categories:

(1) Phantom help: The rescuer charges outrageous fees for light duty phone calls or paperwork that the homeowner easily could do, none of which results in saving

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The Title Insurance Industry

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Like many other industries, title insurance was born of necessity — in this case, the need to protect owners of real estate from challenges to their property titles. During the first century of our nation's history, Americans became all too familiar with land title troubles. In real estate transactions, the name of the game was caveat emptor — "let the buyer beware." The ultimate responsibility for verifying the validity of a land title was the burden of the buyer. As a result, many lost their investments.

It wasn't until 1868 that the problem drew public attention in the Pennsylvania Supreme court case of *Watson v. Muirhead*. After losing his investment at a sheriff's sale as a result of an outstanding prior lien, Muirhead sued his conveyancer. The conveyancer had uncovered the lien, but represented the title as clear after an attorney advised that the lien was not valid.

The court eventually ruled that conveyancers and attorneys could not be held liable for erroneous opinions based on professional standards of evaluation, and Muirhead lost his investment. As a result of the case, it became clear that something was needed to protect innocent investors from similar hazards and to encourage land development and American growth.

From its beginning in 1876 until the 1920's title insurance was more or less local in nature, in that title companies confined their insurance activities to insuring properties in the county in which the company was located and in some cases in contiguous counties. The examination of title was made by employees of the company and usually from a title plant operated by the company.

An expansion in the title insurance industry took place virtually throughout the country from the 1920's to the late 1940's with the title work being done by local attorneys, or by agency companies which were in the abstract business.

Four companies emerged from the World War II era doing a restricted "National" business. It would be more accurate to say that these companies were doing regional business in the late 1940's. They were Lawyer Title Insurance Company, Louisville Title Insurance Company, Kansas City Title Insurance Company and the Title Insurance Company of Minnesota (Old Republic National Title Insurance Company).

In the years subsequent to World War II, a large number of companies which had restricted their operations to local or state-wide insurance began attempting to spread their operations by qualifying first in adjoining states where business opportunities seemed to be the greatest. By 1957, there were approximately 150 companies writing title insurance, 31 of which were licensed in two or more states.

There are laws in every state except Iowa which permit licensing of title insurers upon compliance with applicable state statutes. In most states, title insurance is under the supervision of the State Department of Insurance. Forms of policies are required to be filed in some states and the coverage afforded thereby approved. Title insurance rates and other charges are regulated by some states, in the state of Texas, the insurance Department, rather than the companies, promulgates rates and policy forms, and prescribes underwriting practices in considerable detail.

The emergence of organizations such as F. N. M. A. (Federal National Mortgage Association) served to both stimulate business and to standardize the basic forms of coverage in most states. The American Land Title Association worked closely with lender counsel groups to develop the most popular policy form - the ALTA Loan Policy. In many states, it is common practice to insure the lender but not the owner or purchaser.

The majority of states now limit title insurance companies to a "single line" and do not permit them to issue other types of insurance (property, casualty, life, health, surety, bonds, mortgage guaranty, etc.) In the 1930's, many title insurers which were also guaranteeing the payment of mortgage loans became insolvent as a result of claims under the guarantees and state legislatures passed these "single line" requirements to prevent a reoccurrence.

All states now prohibit the transaction of title insurance without a license. Some states have prohibited rebates or discounts for more than 30 years. Others prohibit title companies from the practice of law and/or conveyancing.

The competition in the title insurance industry has been fierce over the past 20 years. Consolidation of a number of title agencies into national title insurance companies, affiliated business arrangements, joint ventures and the expansion of new players into the vendor management arena has created an industry in the United States with title insurance premium revenues over 12 billion dollars.

Through direct operations and independent title agencies, the title insurance industry customers today include:

- Residential and Commercial real estate buyers and sellers
- Attorneys
- Real estate brokers and agents
- Appraisers
- Surveyors
- Investors
- Mortgage brokers and bankers
- Relocation management companies
- Pension funds and investment managers
- FNMA (Federal National Mortgage Assn – "Fannie Mae")
- FHLMC (Federal Home Loan Mortgage Corp – "Freddie Mac")
- HUD (Housing and Urban Development)
- FHA/VA (Federal Housing Administration)/(Veterans Administration)
- GNMA (Government National Mortgage Association)

Who knows where title insurance industry will be in the next 20 years? ■

Annual Convention

CLTA's 99th Annual Convention

The Palace Hotel
April 28 - May 1, 2007

*Mark Your Calendar
Watch for information in January!*

Other Events

Bankruptcy/Foreclosure 2006

presented by CLTA's Education Committee

October 10 - Concord

October 12 - Ontario

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the home. This predatory scam gives homeowners a false sense of hope and prevents them from seeing qualified help.

(2) The bailout: In this scam, the homeowner is deceived into signing over title to the consultant or more likely, to an accomplice (investor) with the belief that the homeowner will be able to remain in the house as a renter and eventually buy it back over time. The terms of these scams are so onerous that the buy back becomes impossible, the homeowner loses possession and the "rescuer" walks off with most or all of the equity. A key to uncovering this kind of problem can be an uninsured, unescrowed or gift deed to the investor after a Notice of Default records against the grantor.

(3) The bait and switch: In this scam, the homeowners think they are signing documents to bring the mortgage current, instead actually surrender their ownership. They usually don't even know they've been scammed until they're facing eviction. In this scenario, often the grantee from the homeowner takes out a 100% loan against the property leaving no equity, thereby putting all of the original homeowner's equity into the scam artist's pocket.

Of course, many other variations occur in these scams including forgery and fraud of all sorts. It is important that title examiners, title officers and escrow officers recognize the problem. Properly qualified individuals can help homeowners to refinance or sell their property notwithstanding any default or foreclosure of the trust deeds encumbering the property. What is precluded is self dealing by the people promising rescue. Under California law, the consultant must have a written agreement with the homeowner spelling out the services to be performed and the total amount and terms of the compensation to be charged, and the agreement must provide for a three (3) day rescission or "cooling off" period. Most importantly, Civil Code Section 2945.4 prohibits certain practices by foreclosure consultants.

§2945.4 Prohibited practices

It shall be a violation for a foreclosure consultant to:

(a) Claim, demand, charge, collect, or receive any compensation until after the foreclosure consultant has fully performed each and every service the foreclosure

consultant contracted to perform or represented that he or she would perform.

(b) Claim, demand, charge, collect, or receive any fee, interest, or any other compensation for any reason which exceeds 10 percent (10%) per annum of the amount of any loan which the foreclosure consultant may make to the owner.

(c) Take any wage assignment, any lien of any type on real or personal property, or other security to secure the payment of compensation. That security shall be void and unenforceable.

(d) Receive any consideration from any third party in connection with services rendered to an owner unless that consideration is fully disclosed to the owner.

(e) Acquire any interest in a residence in foreclosure from an owner with whom the foreclosure consultant has contracted. Any interest acquired in violation of this subdivision shall be voidable, provided that nothing herein shall affect or defeat the title of a bona fide purchaser or encumbrancer for value and without notice of a violation of this article. Knowledge that the property was "residential real property in foreclosure" does not constitute notice of a violation of this article. This subdivision shall not be deemed to abrogate any duty of inquiry which exists as to rights or interests of persons in possession of residential real property in foreclosure.

(f) Take any power of attorney from an owner for any purpose except to inspect documents as provided by law.

(g) Induce or attempt to induce any owner to enter into a contract which does not comply in all respects with Sections 2945.2 and 2945.3.

(h) Enter into an agreement to assist the owner in arranging, or arrange for the owner, the release of surplus funds prior to 65 days after the trustee's sale is conducted, whether the agreement involves direct payment, assignment, deed, power of attorney, or assignment of claim from

an owner to the foreclosure consultant or any person designated by the foreclosure consultant.

A corollary problem exists with home equity purchasers, which was addressed in legislation that enacted Civil Code Section 1695. Any investor dealing with a homeowner whose residence is in foreclosure must comply with the provisions of this section. This code section does not apply to people who acquire the property for their own use as a personal residence, to deeds from the homeowner to a blood relative or spouse, to deeds in lieu of foreclosure, or to trustee's deeds pursuant to power of sale following a foreclosure. When the code does apply, special provisions must be set forth in the purchase contract, including special cancellation provisions. When the equity purchaser grants the seller an option to repurchase the home, special limitations and obligations also apply. This option to repurchase results in a presumption under the Civil Code that, notwithstanding the absolute deed, the equity purchaser is merely a lender and the purported conveyance is merely a mortgage. Most importantly, when the Code applies, it prohibits any person from taking unconscionable advantage of a property owner in foreclosure. A violation of this prohibition renders the deed voidable. Civil and even criminal sanctions are available when the home equity purchaser violates the provisions of the law protecting these homeowners.

§1695.6 Contract requirements; responsibility of equity purchaser; prohibited transactions; bona fide purchasers and encumbrancers; cancellation; return of original documents; untrue or misleading statements; encumbrances

(e) Whenever any equity purchaser purports to hold title as a result of any transaction in which the equity seller grants the residence in foreclosure by any

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instrument which purports to be an absolute conveyance and reserves or is given by the equity purchaser an option to repurchase such residence, the equity purchaser shall not cause any encumbrance or encumbrances to be placed on such property or grant any interest in such property to any other person without the written consent of the equity seller. Nothing in this subdivision shall preclude the application of paragraph (3) of subdivision (b).

§1695.12 Absolute conveyance with repurchase option deemed loan transaction; rights of bona fide purchasers or encumbrancers.

In any transaction in which an equity seller purports to grant a residence in foreclosure to an equity purchaser by any instrument which appears to be an absolute conveyance and reserves to himself or herself or is given by the equity purchaser an option to repurchase, such transaction shall create a presumption affecting the burden of proof, which may be overcome by clear and convincing evidence to the contrary that the transac-

tion is a loan transaction, and the purported absolute conveyance is a mortgage; however, such presumption shall not apply to a bona fide purchaser or encumbrancer for value without notice of a violation of this chapter, and knowledge on the part of any such person or entity that the property was "residential real property in foreclosure" shall not constitute notice of a violation of this chapter. This section shall not be deemed to abrogate any duty of inquiry which exists as to rights or interests of persons in possession of the residential real property in foreclosure.

§1695.13 Prohibited acts

It is unlawful for any person to initiate, enter into, negotiate, or consummate any transaction involving residential real property in foreclosure, as defined in Section 1695.1, if such person, by the terms of such transaction, takes unconscionable advantage of the property owner in foreclosure.

It is important that title and escrow professionals recognize the problems created by foreclosure consultants and home equity purchasers. Serious losses can result. The "red flags" that raise concern for these problems

include uninsured or unescrowed deeds in the chain, gift deeds or deeds with minimal consideration, the grantor remaining in possession after his conveyance, the grantee taking title "subject to" existing encumbrances and investors taking title after a Notice of Default records. On the escrow side, concern must be given when a foreclosure or default is pending and excessive fees are being paid to advisors and/or proceeds are being diverted from the borrower or seller to an advisor. Often, it is quite easy to recognize a potential foreclosure consultant scam because documents provided to title and escrow staff from the foreclosure consultant (e.g., letterhead, fax or e-mail address) are consistent with the advertising and include terms such as "new beginning", "fresh start", "homeowner's aide." It is important that title and escrow staff not be hoodwinked into clinging to the same cement-life jacket that the distressed homeowner received in the rough seas of economic distress. ■

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