DATA SEARCH

Intended Audience: Title Insurance Clients

Title: July 8, 2011 - Explanation of Gap Coverage

The issue to be discussed is coverage for items that appear in the "Gap"; what exactly the insured is covered against and what they assume liability for. The gap is the period in time between the "thru date" or "effective date" of the title report and/or commitment and the date the title report or most recent update is completed.

Example 1:
A title report is completed on February 1st, with a "thru date" of January 1st; the commitment would be issued with the effective date of January 1st. The "gap" is the period of time between January 1st and February 1st whereby the indices (an index is what an abstractor uses to search the land records) are not yet updated. If an update were done on February 15th, the effective date would change to the new thru date as of February 15th. So if the records were approximately 30 days behind, the assumption would be that the new thru date as a result of the update would be January 15th.

What is covered and what is not seems to be unclear in title insurance circles and with an emphasis on coverage being a focal point for mortgage lenders, we inquired into this "grey" area and have created quite a discussion and debate between a couple underwriters and their legal teams. The issue was clear; what level of gap coverage is provided to the insured through the issuance of the ALTA Loan Policy of Title Insurance and who is liable for what?

The ALTA 1992 Policy did not contain any language that would provide any form of gap coverage. Most lenders assumed that if they had a policy without specific exceptions, then they were covered. In other words, if a lien was filed in the gap and it did not appear on the policy, they assumed they were covered. This assumption, legally anyway, was incorrect. When a claim arose due to the gap issue, the underwriter had two choices:

a. Pay the claim as a condition of doing business, or
b. Deny the claim based on the exception that appears on every commitment to insure

Defects, liens, encumbrances, adverse claims or other matters, if any; created first appearing in the public records or attaching subsequent to the effective date thereof; but prior to the date of the proposed insured acquires for value of record the estate or interest of mortgage thereon covered by this Commitment.

The above exception implies that any lien or defect that appears in the gap, regardless of whether it appears on the final policy as an exception, is excluded from coverage under the terms of the policy.

With the introduction of the ALTA 2006 Policy, we can only assume the authors decided that since many lenders already assumed that they had gap coverage, they should include this provision in the new policy. It would have served the industry well had they defined the "gap" first before making such a decision. The following is what they provided in the Covered Risks Section of both the Owners and Loan Policy:

Any defect in or lien or encumbrance on the Title or other matter included in Covered Risks 1 through 13 that has been created or attached or has been filed or recorded in the Public Records subsequent to Date of Policy and prior to the recording of the Insured Mortgage in the Public Records. The Company will also pay the costs, attorneys' fees, and expenses incurred in defense of any matter insured against by this Policy, but only to the extent provided in the Conditions.

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The above implies that standard coverage within the 2006 Policy includes gap coverage for anything that would appear after the Date of Policy and before the recording date of your security instrument. The date of policy is the date that the settlement took place, so your coverage under this paragraph does not include that which would be recorded after the effective date of the commitment but before the settlement date of the loan. Some attorneys and underwriters understood this to mean the "entire" gap from the effective date of the commitment to the recorded date of the security instrument; we believe the language is fairly clear and that only a small portion of the gap is covered, an opinion shared by other industry experts as well.

Example 2:
A title report is completed on February 1st with a "thru date" of January 1st; as such the commitment would be issued with the effective date of January 1st. The "gap" is the period of time between January 1st and February 1st whereby the indices (an index is what an abstractor uses to search the land records) are not yet updated, or approximately 30 days. If an update were done on February 15th, the effective date would change to the new thru date as of February 15th. So if the records were approximately 30 days behind, the assumption would be that the new thru date as a result of the update would be January 15th, and the new effective date of the commitment would be January 15th as well. If the loan closes on February 15th and the documents are recorded on February 18th, the ALTA 2006 Policy would provide coverage for any defect or lien filed during the period of time between the 15th of February and the 18th of February. The 30 day gap would still exist and there is nothing in writing that provides the insured with coverage for this period of time, in fact it is specifically excluded in the commitment.

The Title Insurance Industry in their infinite wisdom never really took into account what would happen if the loan to be insured were not closed by the agent; we assume they thought all loans would be. So the forms, binders and coverage were written with the assumption that an agent always closed the loan, not necessarily the case, and as such created a grey area in the coverage for lenders that close their own. This can leave the lender with unexpected liability depending on the underwriter's decision at the time of the claim.

When we close a loan it is our responsibility as an agent to do an update prior to the closing; normally it is done a day prior as to not hold up a settlement. When this is done, and we handle the documents according to the closing instructions of the lender, the underwriter is willing to provide gap coverage from the time of the update through and including the date of the recording of your document. This provides the lender with complete gap coverage.

We use two different underwriters, each having a different opinion. Additional research supports that the industry as a whole is divided on the subject, but it appears that most assume the agent is closing the loan not the lender, and their opinion is based on the same. One underwriter takes the position that as long as the documents are provided to the agent for recording in a timely manner, and the agent does an update prior to recording and nothing is disclosed, then the insured should be covered for any item in the gap assuming they did not have prior knowledge of the issue or violate any other condition in the policy. They see this as a standard risk of the insurance industry and could find no fault in the duties of the agent. Another underwriter takes a more hard-lined position, requiring that the agent close the loan and performs the recording. Then the insured should be covered for any item in the gap assuming they did not have prior knowledge of the issue or violate any other condition in the policy. Since there is nothing concrete that is written to support either, who is to say what is right or wrong but as an agent we are obligated to follow the direction of our underwriter.

I believe that defending a claim based on the fact there is a difference between the lender closing the loan and the agent closing the loan would be extremely difficult as would convincing a court to rule solely based on this fact. If the underwriter were to lose such a case, they would then have the ability to pursue the agent if they believed the agent failed in their duties as defined in the underwriting agreement. So, if they require we close the loan to provide the gap coverage, and we don't, they could claim we were the cause of their liability and hold us financially responsible. Clearly not a risk we want to assume and so we follow the most conservative path.

We were also advised that by the issuance of an Insured Closing Letter (ICL), the lender would in fact have complete gap coverage. The ICL basically states that the lender is covered should the agent not follow all of the lenders closing instructions, but nowhere does it state anything about the gap. One underwriter's position was if all the closing instructions were followed then they are obligated to insure the gap; the others position is that the ICL has nothing to do with the gap and affords no additional gap coverage that would not be already afforded in the policy, a position we happen to agree with.

In Summary:
If we do not close the transaction, a lender should be covered for any item filed in the gap unless it is discovered during the update done prior to the recording of the document. Your risk is having a lien discovered after the closing took place but before the documents were recorded. If this occurs, they would have to be dealt with or be listed as an exception on the policy and hopefully you have not yet disbursed the loan. An additional risk is if the documents are not sent to us for recording in a timely manner or are sent direct to the courthouse without our knowledge, you would not have any coverage for the gap until the thru date is current to the date of the recording of your documents. If the documents are sent in accordance with the above and nothing were discovered during the update, then you would have full coverage for anything in the gap, assuming you did not have prior knowledge of the issue or violate any other condition in the policy.

If we close the loan, you would be covered for any item filed in the gap and not reported to you prior to the closing, assuming you did not have prior knowledge of the issue or violate any other condition in the policy.

The biggest difference between the two is when the update is actually done. When we close the loan, the update is done prior to closing; when the lender closes, the update is done prior to recording. When the lender closes we have no control over the closing and have no choice but to update in this manner. We could provide an update to the client prior to their closing the loan but in the event that the closing failed to take place on the day they originally informed, a grey area could once again exist in your coverage. Also an additional charge for each update would be incurred and although this cost almost certainly is less than the cost of us closing the loan, a potential liability to the lender would still exist.

The other issue we dealt with was that of the standard exception in the commitment. If this exception exists, there can always be doubt concerning gap coverage. In order to remove the standard exception referenced above, we must do the closing and have complete control over the process. In addition we would add new requirements to the commitment that would:

a. Require we close the transaction
b. Require that any defect, lien or encumbrance found during the pre-closing update be satisfied

This would provide you with absolute gap coverage, regardless of the underwriter assuming you did not have prior knowledge of the issue or violate any other condition in the policy. It would also satisfy all underwriters.