Not My Problem

Your man on the corner frequently hears agents and buyers say that lender's title insurance protects a buyer to the extent of the loan. This is particularly true, they say, when there is little or no equity in the property. Nothing could be further from the truth.

A lender's title insurance policy affords a buyer no protection whatsoever. That insurance contract is between the lender and the title insurance company. Only the lender can make a claim on its policy. A lender will only make a claim on its title policy when the lender's security interest is impaired, and impaired is not the same thing as threatened. This is an important distinction, which I will address later.

Think of title insurance like car insurance. And assume on our metaphorical car that you have borrowed money in order to buy it. If your car is stolen and if you do not have insurance to cover that loss then you still owe the loan to the bank regardless whether you have the car or not. Just like with the car, our real estate buyer executed a note to his bank: trust me that nowhere does that note say "but if you lose the house the loan is forgiven." So, if the proverbial defrauded-prodigal-wife-in-the-chain-of-title shows up on the new buyer's doorstep and rightly says, "get out of my house" then your buyer still must pay the loan to the lender.

Suppose in our example the buyer then called the title insurance company and said I have lost my house, please pay the loan. The title insurance company would rightly say that the buyer is not its insured, the lender has made no claim on the policy, and it is not its problem. It would only be when the purchaser failed to make payments, thus driving the property into foreclosure, that the lender's security interest would be impaired (it would be unable to foreclose without clear title). But it would be the one making the claim, not the buyer, and it alone would receive payment. Note that since there is no collateral upon which to foreclose, there are no sale proceeds available to satisfy the loan.

At that point the title insurance company would indeed pay the loan off pursuant to the policy. In doing so they are "subrogated" to the lender's rights. Think of "subrogation" as the title insurance company legally stepping into the bank's shoes. And standing in the bank's shoes the title insurance company can turn to the buyer and say: you agreed to pay this loan, now pay. If the buyer does not pay then the title insurance company can sue the purchaser on the note. In other words, the title insurance company has purchased the note from the buyer and is entitled to those payments.

Therefore, the only mechanism by which a buyer is protected by title insurance is through a policy issued in the buyer's name, for the buyer's benefit. So, follow the advice of your Association's Weapon of Mass Instruction and disabuse your client of the notion she is protected by a lender's policy, else she will hear those fateful three words from everyone: "not my problem."