Insurance Claim--Mortgagee Noncompliance with Regs.

Legal Opinion: GHM-0053

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Subject: Insurance Claim--Mortgagee Noncompliance with Regs.

December 21, 1992

MEMORANDUM FOR: Stephen Reynolds, Staff
Title X Asset Management, HSI

FROM: Donald A. Franck, Chief Attorney, Loan Management
and Property Disposition Section, GHM

SUBJECT: Port Arthur Title X Projects
Project Nos. 114-46026/114-46027
(L-1361)

This is in response to a computer mail message from Victor Vacanti of the Office of Multifamily Insurance Accounting and Servicing and your November 9, 1992 telephone call in which you requested our advice concerning whether the Department would be required to pay insurance claims on the captioned project mortgages.

It is our understanding that the two Title X projects, Lake Arthur Manor and Park Central NITI, have been in default since 1986 and, in May, 1992, both mortgages were foreclosed by the U.S. Department of Commerce ("Commerce"). Since that time, Commerce has not made an election to convey the properties to HUD. We have also been informed that mortgage insurance premiums for both projects are delinquent, the maturity dates of each loan have passed and Commerce is not an FHA-approved mortgagee. You question whether under these circumstances the Department would be obligated to pay a claim for insurance benefits if Commerce made an election to convey the property.

Section 207(g) of the National Housing Act ("NHA"), which, pursuant to Section 1009 of the NHA, is applicable to Title X mortgages, states that if the mortgagor fails to make any payment due under the terms of a mortgage insured under this section and "if such default continues for a period of thirty days, the mortgagee shall be entitled to receive the benefits of the insurance as hereinafter provided, upon assignment, transfer, and delivery to the Secretary, within a period and in accordance with rules and regulations to be prescribed by the Secretary" of all rights and interests arising under the mortgage. Title 24 CFR 207.255, adds the additional requirement that the mortgage default must continue for a period of 30 days before the mortgagee shall be entitled to receive insurance benefits. However, 207.251(g) of the regulations defines "mortgagee" as "the original lender under a mortgage its successors and such of its assigns as are approved by the Commissioner ...." Therefore,

since Commerce is not an FHA-approved mortgagee, it would not be eligible to receive insurance benefits.

Even if Commerce were to become an FHA-approved mortgagee or transferred its mortgagee rights to an FHA-approved lender, we are of the opinion that it would have forfeited its rights to insurance benefits by the fact that it has foreclosed and has not provided notice to HUD of its actions or intentions.

Section 207(n) of the NHA provides the Secretary with authority for the Secretary to unilaterally terminate the insurance contract. Section 207(n) provides that in the event a mortgage becomes in default through failure of the mortgagor to make any payment due, the mortgage continues in default for 30 days, but the mortgagee does not foreclose on or otherwise acquire the property, and the Secretary is given written notice thereof, all rights of the mortgagee and the mortgagor the insurance contract shall terminate as of the date of the mortgagee's notice. While Section 207(n) makes it clear that the mortgagee's failure to take action regarding the loan or the property, combined with notice to the Secretary of such inaction, terminates the mortgagee's rights under the contract of insurance, it does not address the converse situation, i.e., when the mortgagee has foreclosed but has not notified the Secretary of its intentions. Section 207.253a of the regulations also addresses cases in which the Commissioner may terminate the contract of insurance, but the precondition is that the mortgagee must have elected to convey the property to the Commissioner. Hence, we have looked to common law for guidance.

It is a general principle of insurance law that once there is a loss under the terms of a policy, notice of loss should be given with as little delay as the circumstances will permit or within a reasonable period of time after discovering the loss. There are, however, exceptions to this general rule. For example, a failure to give notice of a loss would not forfeit the right of the insured to recover under the insurance policy unless an express condition of forfeiture were contained in the policy. Also, late notice generally will not bar recovery under the policy unless the insurer has been harmed in some way. However, if a definite time limit is fixed by the policy for notice, failure to comply therewith could bar recovery under the policy.1

Several cases also support the contention that Commerce has forfeited its rights under the insurance policy. In RTE Corporation v. Maryland Casualty Company, a case concerning a loss under a contract for property insurance, the Supreme Court

1 John Allen Appleman and Jean Appleman, Insurance Law and Practice 3501 (1970).

of Wisconsin held that the insured has a duty to provide prompt notice to the insurer of a loss, i.e., destruction or damage to property, and, under the circumstances of this case, nine months

was too long a period. 74 Wis.2d 614, 247 N.W.2d 171 (1976). Other cases have held similarly.2 In all of the cases examined, the courts looked to the time period specified in the contract to determine whether notice was given in a timely fashion, and if no notice was specified, the courts looked to a time period which would be reasonable under the circumstances of the case.

Section 207.256(a) of the regulations states that if the default is not cured within the 30 days grace period, "the mortgage e shall within 30 days thereafter notify the Commissioner in writing of such default." This provision gives clear notice to mortgagees that whenever there is a monetary default (as defined in 207.255(a)), the mortgagee shall provide notice of the default to the Commissioner. Hence, under the general principles of insurance law and case law, Commerce would be barred from asserting an insurance claim due to its failure to timely notify the Commissioner of the defaults.

In light of our conclusion that Commerce would not be entitled to insurance benefits if it were to file a claim, you may wish to notify Commerce that the Department is terminating its insurance contract on the basis of its material non-compliance with the notification requirements of the regulations and also request MIAS to terminate the insurance on its records.

If you have any questions, please call Monica Jordan at 708-4107.

2 See, Atlantic Joint Stock Land Bank of Raleigh v. Foster, 2117 N.C. 415, 8 S.E.2d 235 (1940) and Patrick v. Auto-Owners Insurance Company, 5 Ohio App.3d 118, 449 N.E.2d 790 (1982).